Reserve Oil and Gas Company
1973 Annual Report

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Vice President-Operations

Robert E. Aberley, Apple Valley
Vice President and Treasurer

Annual Meeting

The Annual Meeting of Shareholders will be held at 10:00 a.m., on April 29, 1974 in the Assembly Room, 3rd floor, 550 South Flower Street, Los Angeles, California. The notice of meeting and proxy statement are mailed with this annual report.

Reserve Oil and Gas Company

Executive Offices:
550 South Flower Street
Los Angeles, CA 90017

The cover graphic symbolizes, by the drilling bit at the upper left, the Company's oil and gas exploration and development activities; by the Western Crude logo at the upper right, its crude oil purchasing, transporting and marketing activities, both domestic and foreign; by the Mohawk Indian head at the lower left, its gasoline and petroleum product refining and marketing activities; and by the montage at the lower right, the land development business of the Company.

Drilling rig on well, Saik #1, South Carlsbad Field, Eddy County, New Mexico (See page 14)

Contents

Financial and Operating Highlights

Financial	1973	1972
Total revenues	$406,007,000	$259,200,000
Income before extraordinary credits	10,333,000	4,704,000
Per common share	.81	.36
Extraordinary credits	2,000,000	1,224,000
Per common share	.16	.10
Net income	12,333,000	5,928,000
Per common share	.97	.46
Working capital	27,491,000	14,628,000
Shareholders' equity	86,979,000	73,385,000
Total assets	196,543,000	135,029,000
Operating		
Crude oil and natural gas liquids production, barrels per day	10,153	10,028
Natural gas sales, Mcf per day	32,226	35,955

Ten Years, 1964-1973

Reserve Oil and Gas Company Summary of Consolidated Financial Statement Items Previously Reported in Annual Reports to Shareholders

Amounts in Thousands	1973	1972	1971	1970	1969	1968	1967	1966	1965	1964
Shareholders' Equity	$ 86,979	$63,277	$60,996	$55,018	$57,989	$35,988	$22,172	$20,436	$ 9,449	$ 7,978
Total Assets	196,543	86,609	80,452	74,010	80,008	64,683	45,912	34,285	15,602	11,864
Revenues	406,007	56,625	48,541	43,448	44,337	16,257	11,322	11,312	5,776	5,580
Income, before extraordinary items	10,333	3,975	3,674	2,894	2,959	1,975	1,696	1,803	15	48
Net Income (loss)	12,333	5,143	3,674	(2,484)	4,382	2,308	1,924	1,803	880	211
Working Capital	27,491	12,336	10,854	10,612	9,243	7,489	7,190	6,074	2,159	2,176
Average Common Shares Outstanding	12,271	9,328	9,328	9,324	8,933	7,388	4,506	4,503	1,685	1,470

The information above does not reflect retroactive restatements for poolings of interests which occurred in 1968, 1969, and 1973, or for a change in the method of accounting for retail land sales which took place in 1972. Therefore, the information presented is not in accordance with generally accepted accounting principles and differs from the statistical information which appears on page 29 of this report.

From the Chairman

The accumulative momentum of the ten building years—since 1963—has now begun to fully show significant results. 1973 was a milestone year for Reserve, because not only were new record highs again achieved but the rate of growth was by far the greatest in the Company's history. In summary:

INCOME BEFORE EXTRAORDINARY CREDITS:	$10,333,000	up 120%
PER COMMON SHARE:	81¢	up 125%
NET INCOME:	$12,333,000	up 108%
PER COMMON SHARE:	97¢	up 111%
GROSS REVENUES:	$406,007,000	up 57%
FUNDS FLOW:	$24,396,000	up 89%
WORKING CAPITAL AT YEAR END:	$27,491,000	up 88%

Leading the important factors in the achievement of these results was the merger of Western Crude Oil, Inc. into Reserve in April. This wholly-owned subsidiary has had a steady growth pattern in all of its lines of business since it was founded in 1967. Its growth in 1973 was notably greater than in any prior year. It is continuing to expand its principal business, and related activities, of purchasing, gathering, transporting and marketing crude oil in the U.S., in Canada, and, since 1972, in international markets.

Among the highlights of Western Crude's 1973 achievements are new crude oil supplies provided to Mohawk's refining operations; substantial expansion of its liquefied natural gas product sales; acquisition of a 25% interest in Texoma Pipe Line Company which will construct a $97 million crude oil pipeline from Texas to Oklahoma; a 10% increase in ownership in Butte Pipe Line Company, which is a 413-mile common carrier pipeline running from Baker, Montana, south to Fort Laramie-Gernsey, Wyoming; the acquisition and expansion of a 137-mile crude oil pipeline in northeastern Montana; the commencement of deliveries of crude oil by the 33⅓% owned Wascana Pipe Line System from Regina, Saskatchewan, Canada to Poplar, Montana; a 40% joint venture participation in a modern refining complex in Colorado; and establishment of a firm base for steadily growing crude oil and finished petroleum product trading, processing and shipping operations in the Eastern Hemisphere.

Exploration and development activity continued at an accelerated pace on the Canadian Reserve holdings in Canada, with a large measure of success. Financial results for Canadian Reserve were also favorable in all categories.

At Kotcho in Northeast British Columbia, where the Company's b-43-J well was completed as a new field discovery in January of 1973 with an absolute open flow potential of 210 million cubic feet of gas per day in the Middle Devonian, a follow-up well, the d-71-G, was completed later in 1973 in the Devonian with an indicated absolute open flow potential of 52 million cubic feet of gas per day. This is a separate new field discovery. Both of these wells also indicated commercial production in the Cretaceous Bluesky formation. Exploration to the east was unsuccessful, but a stepout test, b-68-H, 2 miles to the southeast of the d-71-G has been tested for 2.2 million cubic feet of gas per day in the Bluesky and was just completed as a new field discovery in the Devonian reef. Canadian Reserve owns a 37½% interest in these discoveries. First sales from Kotcho are anticipated in April at a price of 22¢ per thousand cubic feet.

Exploration and development continued in the Fireweed (Jeans) and West Jeans area with the result that 4 additional gas wells, in which the Company's interest ranges from 10.8% to 21.7%, have been completed.

In the heavy crude area in Saskatchewan and Alberta major development programs were conducted in the Lone Rock-Epping and Eyehill regions of Saskatchewan and in the Bodo region in Alberta. Canadian Reserve participated in 31 exploratory wells and 35 development wells on Company lands during 1973 in this heavy crude area. Thirty-one gross development wells (8.4 net wells to Canadian Reserve) were completed as oil producers, 14 exploratory wells (6.5 net) were completed as oil discoveries, and 4 wells (1.1 net) were completed as gas discoveries.

The Horn River Middle Fiord J-53 well on Axel Heiberg Island has been abandoned. However, Canadian Reserve has earned a 7.15% interest in 271,000 acres around the well.

Additional drilling in 1974 for light oil in Southeastern Saskatchewan has resulted in extension discoveries at Steelman, Star Valley, Douglaston and Glen Ewen, where the Company average ownership is 55%. These wells produce 38° gravity oil from the Midale and Frobisher zones above 4,000 feet. Some 20 development wells capable of 75 barrels per day each are expected to result from this exploration.

U.S. exploration resulted in successes in the South Gomez Field, Pecos County, Texas and in the South Lake Charles area, Calcasieu Parish, Louisiana. Although Reserve's interest is minor, substantial revenues are being realized from these wells.

On the 3-million-acre Colombia concession, in which Reserve has a 12½% interest, the first exploratory well, the Nancy No. 1, flowed on test at a stabilized rate of 2,360 barrels of 27° API gravity oil through a ½″ surface choke. The well is presently shut in awaiting a pipeline connection at a distance of about 15 miles into the Trans-Andean Pipeline running to the Port of Tumaco on the Pacific Coast. The second exploratory well, the Burdine No. 1, is located about 3.5 miles northeasterly of the Nancy No. 1 and is now drilling.

The seismic work done on this concession has delineated several anomalies which appear to fully warrant drilling. It is anticipated that at least two more exploratory wells will be drilled on the concession during 1974.

Mohawk had another record year—the fourth in a row. Gasoline sales increased to 165 million gallons for the year, a 21% increase over 1972. In the last 4 years, including 1973, sales of gasoline have increased a total of 95%.

Mohawk's postion was strengthened by increased supplies of crude oil made available to it at the end of 1973 by Western Crude Oil, Inc. In anticipation of a reasonably assured supply of crude in 1974, Mohawk completed in the latter part of 1973 modifications to Crude Unit No. 4 at its Bakersfield Refinery, increasing its capacity 1,600 barrels per day. Early in 1974 renovation and reactivation of the 3,500 barrel per day Crude Unit No. 2, previously shut in, was completed. With these improvements the operating capacity of the refinery has been increased 30%, for a new total daily capacity of 22,100 barrels.

Early in 1974 Mohawk commenced to operate under the mandatory regulations of the Federal Energy Office established by the Emergency Petroleum Allocation Act of 1973, which imposes controls on supply and distribution of crude and allocates the sale of products. Mohawk will continue to comply with these regulations, and it appears that with such compliance the Company can maintain its present crude supply and product distribution and sales lines at satisfactory and profitable levels.

Apple Valley continues to be a profitable component of the Company's business. In 1973 the water company, a public utility owned and operated by Reserve, installed meters for 172 new residences and business buildings. This is the fifth consecutive year of increased construction activity, which was up by 15% in 1973 compared to 1972. Two new business complexes were constructed in the Desert Knolls area. The Apple Valley Chamber of Commerce will relocate there, along with a number of new businesses, including a dress shop, beauty salon, flooring company and an Artist's Center.

A number of executive management changes occurred during the year. As your new Chairman of the Board, I will continue as Chief Executive Officer. Newton T. Bass was elected Chairman Emeritus and will serve the Company in a senior executive capacity. Paul D. Meadows was appointed to the new post of President and Chief Operating Officer. On January 1, 1974 he established general operating offices for the Company in Denver. He will continue as President of Canadian Reserve.

We report with great sadness the death of Marco F. Hellman in October of 1973. His contributions to the Company as a Director and as its Financial Advisor were very significant and he will be sorely missed.

Cortlandt S. Dietler, President of Western Crude, joined the Board of Directors in April. Harold F. Green, Vice President and Secretary, was elected a Director in November.

1973 witnessed rapid and in some cases turbulent changes in many aspects of the natural resources business. 1974 may well require major adjustments to even more challenging changes. Your Company and its highly dedicated people will continue to seek out ways to meet these challenges with a view to continuing the pattern of higher profit levels and additional growth.

John R. McMillan

FOR THE BOARD OF DIRECTORS
John R. McMillan, Chairman

March 28, 1974.

Exploration, Development and Operations

Canadian Reserve Oil and Gas Ltd.

LAND

On December 31, 1973 Canadian Reserve held working interests in a total of 18.3 million acres (10.2 million net) and overriding royalty interests in 4.0 million acres throughout Canada in the Western provinces, the Arctic Islands, the East Coast offshore, and the Yukon and Northwest Territories. Productive land holdings of the Company in the Western provinces totaled 314,000 acres (86,300 net). Still under permit application are 14.7 million acres (4.9 million net) located off the East Coast of Canada.

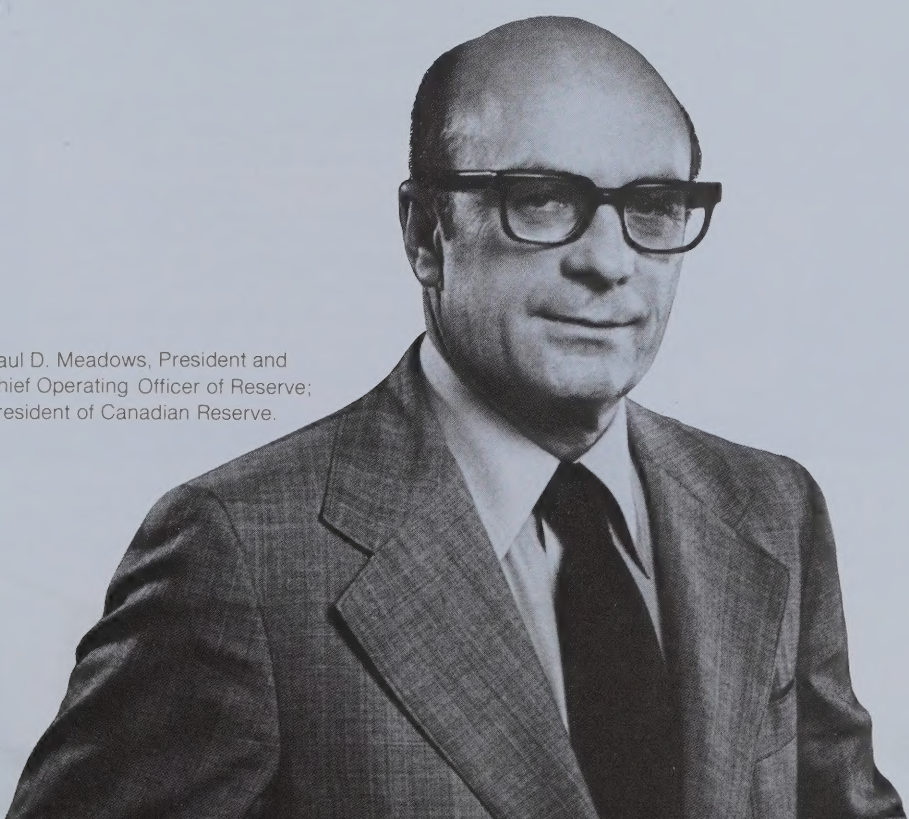
Throughout 1973 the Company continued its policy of reducing the large work commitments on frontier land holdings by means of farmout and work credit arrangements. Agreements were concluded on 1,672,550 acres in the Nansen Sound and Eureka areas of the Arctic Islands and on 600,500 acres in the Amundsen Gulf area of the Northwest Territories. By virtue of these agreements, these lands will be maintained at no cost to the Company.

The Company realized $200,00 from the sale of a portion of the gross overriding royalty interest held on the 1,307,400-acre Banks Island block.

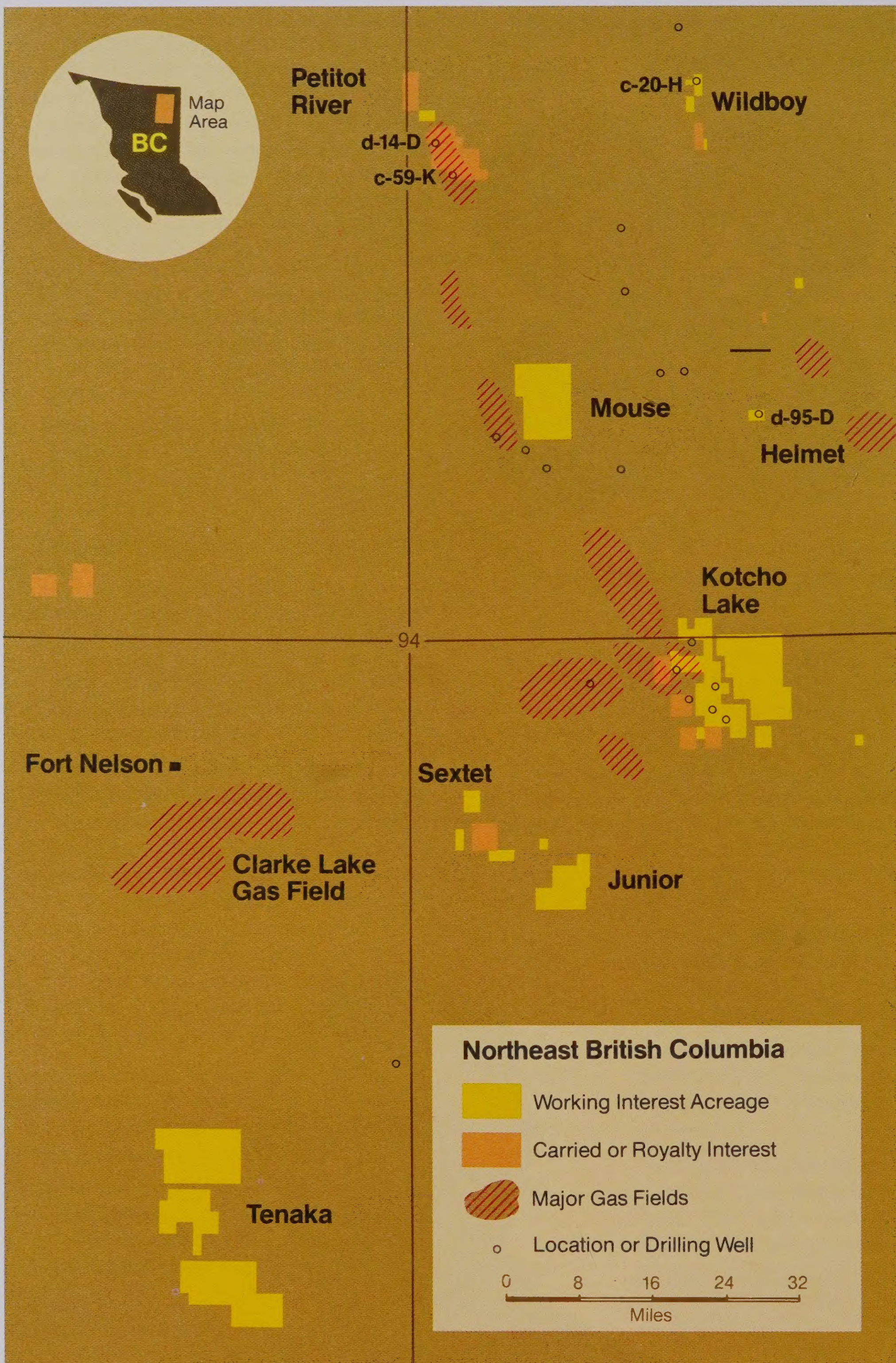
EXPLORATION AND DEVELOPMENT

During 1973 Canadian Reserve continued to emphasize exploratory and development programs in areas of the Company's discoveries, which resulted in major exploration expenditures in Northeast British Columbia and the heavy crude oil region of Alberta/Saskatchewan.

A summary of the more significant exploration and development activities of 1973 follows.



Paul D. Meadows, President and Chief Operating Officer of Reserve; President of Canadian Reserve.



British Columbia

During 1973 the Company participated in the drilling of 6 successful exploratory gas wells in northeast British Columbia (See map at left). One of the wells (d-71-G) at Kotcho was a dual zone (Cretaceous and Devonian) new field discovery and is discussed in detail under the Kotcho area. The other five are located in the Fireweed/Jeans and Monkman Pass areas. (See map, page 8)

Canadian Reserve reduced its net carried interest acreage from 79,096 acres held in 1972 to 31,788 acres in 1973 but improved its working interest acreage position from 96,432 net acres to 123,068 net acres in the same period.

KOTCHO AREA: A new field discovery, the d-71-G well, which is located approximately 4 miles from the Company's b-43-J Devonian gas well, was successfully completed in 1973 (see map, page 7). This new discovery well was tested with an absolute open flow of 52 million cubic feet of gas per day from the Middle Devonian reef member. A drillstem test of the Cretaceous Bluesky formation in the well resulted in a flow rate of 3.9 million cubic feet of gas per day. This stepout exploratory well revealed a new reef trend which is being further explored during the 1973-74 drilling season. At year-end a stepout test (b-68-H) 2 miles to the southeast of the d-71-G well was nearing completion in the Middle Devonian, after confirming gas in the Bluesky formation with a drillstem test of 2.2 million cubic feet of gas per day.

Results to date have established the presence of two major gas accumulations at Kotcho. The first is indicated by the b-43-J well which demonstrated an absolute open flow potential of 210 million cubic feet of gas per day in January of 1973. The other is indicated by the d-71-G well noted above. Further drilling is in progress to delineate the size of these discoveries and search for new gas fields in the area.

Canadian Reserve holds varying interests of 37.5% and 50.0% in blocks totaling 67,051 acres (33,489 net) in the Kotcho area.

TENAKA AREA: Follow-up drilling of the b-14-G well in 1973 as a 1½ mile stepout to the Adsett a-36-G Devonian gas discovery completed in August, 1972 was unsuccessful. Additional seismic and subsurface data indicate that a major Middle Devonian reef barrier extends north and east of previous exploratory drilling. Follow-up drilling is planned for this area in the winter season of 1973-74.

The Company owns a net 38,079 acres out of a gross 82,495 acres of petroleum and natural gas rights in this area.

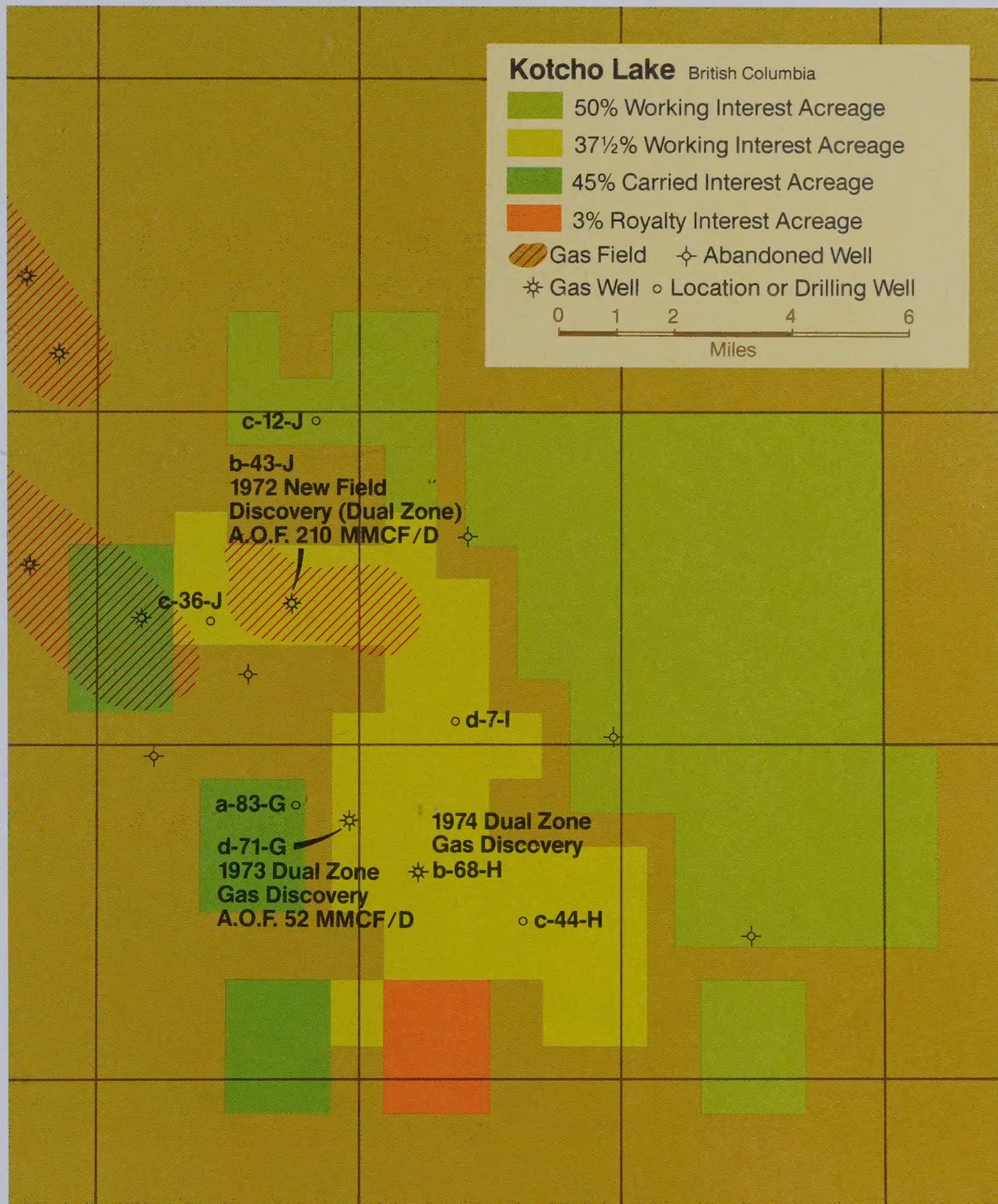
FIREWEED (JEANS) AREA: Additional drilling in the Fireweed area during 1973 (see map, page 8) resulted in 2 gas wells and 2 dry holes. The gas wells, b-4-H and b-22-H, were completed in the Dunlevy and Bluesky zones respectively and increased the Company's marketable gas reserves in this area.

The Company owns an interest in 23,126 acres (3,917 net) in this area.

WEST JEANS AREA: Two successful gas wells were drilled during 1973 (see map, page 8). The d-55-B and d-11-F wells encountered commercial quantities of gas in the Dunlevy formation and expanded the extent of the Company's gas reserves. The former well had an absolute open flow of 2.2 million cubic feet of gas per day, while the latter drillstem tested gas at a rate of 3.2 million cubic feet per day.

Like the Fireweed area, production here is shut in awaiting first gas sales which are expected to occur in 1974.

Canadian Reserve holds an interest in 25,556 acres (4,631 net) in the West Jeans area.



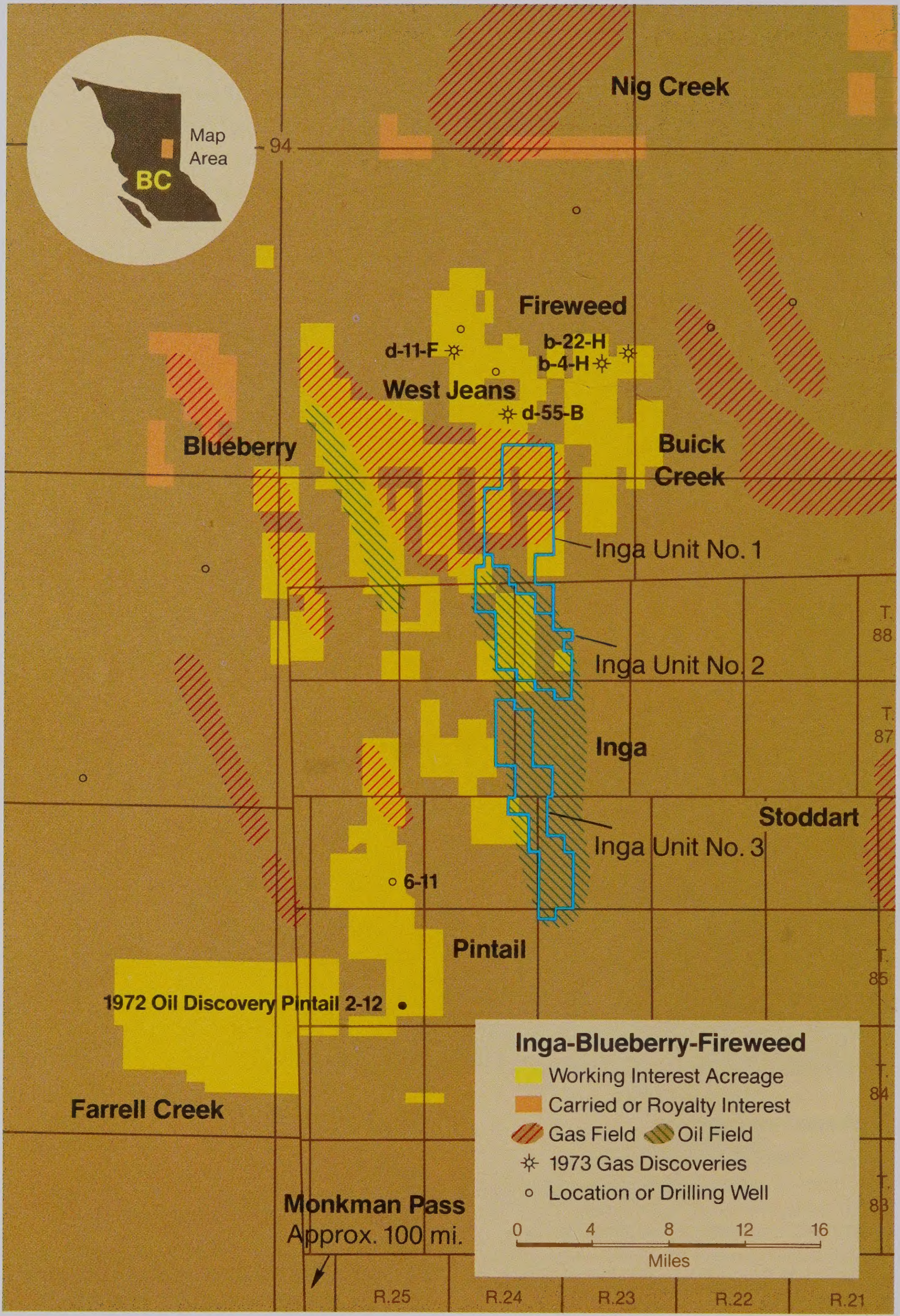
Saskatchewan/Alberta

HEAVY CRUDE AREA: Significant new discoveries and successful development drilling projects during 1973 resulted from a continued emphasis on exploratory and development programs in the heavy crude oil areas of Saskatchewan and Alberta (see map, page 9).

Canadian Reserve participated in the drilling of 31 exploratory wells and 35 development wells on Company lands during 1973 within the heavy crude oil area. As a result of this drilling program 31 gross development wells (8.4 net) were completed as oil producers, 14 exploratory wells (6.5 net) were completed as oil discoveries, and 4 wells (1.1 net) were completed as gas discoveries.

The development and exploratory area names are included on the map on page 9 and are used in the following discussion. The major development programs were conducted in the Lone Rock-Epping area of Saskatchewan and at Bodo on the Alberta side of the heavy crude oil area. Exploratory drilling occurred in the Manito, Yonker, Senlac and Eyehill areas of Saskatchewan and along the Bodo-Hayter trend in Eastern Alberta.

Harold F. Green, Vice President and Secretary.



Canadian Reserve owns 651,305 acres (297,627 net) of exploratory lands lying along both sides of the Saskatchewan/Alberta border and in the immediate vicinity of the Lone Rock-Kerrobert pipeline system. A farmout to another company was negotiated in 1972 to assist in the evaluation of a large part of this acreage.

The earning phase of the farmout was completed in 1973 which included the drilling of 39 exploratory wells (25 in 1972 and 14 in 1973). This program resulted in 7 oil wells, 7 gas wells and 25 dry holes. Upon completion of all earning wells, Canadian Reserve's interest in the farmout lands was reduced to 25% from its original 50% position in most of the lands. Canadian Reserve will participate as to its retained interest in all subsequent development and exploration drilling on the 269,945 gross acres included in the farmout.

The exploratory effort in this area, through an original joint venture with Murphy Oil Company Ltd. and the above mentioned farmout, has resulted in new field discoveries at Manito, Yonker, Eyehill and Senlac in Saskatchewan and in the Bodo-Hayter areas in Eastern Alberta. Significant proven reserves have been added to the Company's interests in the Bodo Field area, whereas the remaining discoveries require additional follow-up drilling to delineate the size of the oil accumulation and associated recoverable oil reserves.

At Bodo, in Township 37, Range 1 W4 in Alberta (see map, page 10) the discovery well was drilled in 1972, with 12 follow-up wells completed in 1973. At year-end, 12

Howard C. Pyle, Director

Waseca sand oil wells and 2 Sparky oil wells were completed within the indicated Bodo Field limits. Ten wells are on production from the Waseca sand and preliminary information is encouraging relative to producibility of the heavy oil. The average production rate for these wells is 50 barrels of oil per day.

Yukon and Northwest Territories

During 1973 exploratory drilling by the industry resulted in 6 new discoveries during the year, bringing the total to date to 13 (2 oil, 1 oil and gas, and 10 gas). No discoveries were made outside of the Mackenzie Delta area.

Under terms of a previously reported farmout agreement, Ashland Oil Canada Limited et al. plan to drill a 5,000-foot lower Paleozoic test on Company lands at Colville Lake in the Northwest Territories. The Ashland et al. Tedji Lake F-24 location is favorably positioned on an extensive seismic anomaly and will be of great interest to Canadian Reserve. After completion of the exploratory well Ashland et al. will have earned a 50% interest in the 664,428-acre block. Future operations will then be conducted as a 50-50 joint venture with the Company.

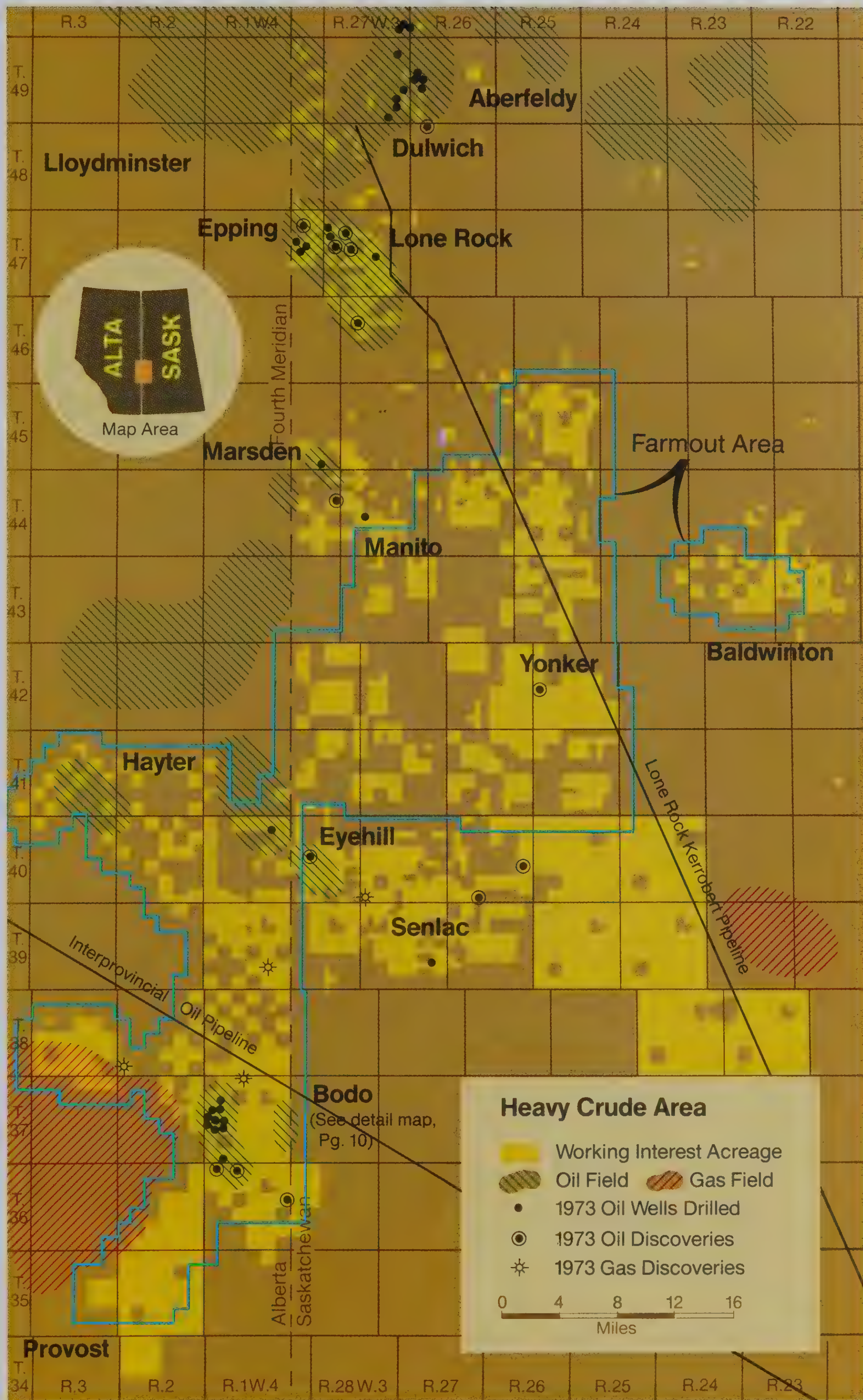
Canadian Reserve owns 2,201,423 acres (1,200,371 net) of petroleum and natural gas rights plus overriding royalty interests in 1,849,389 acres in the Yukon and Northwest Territories.

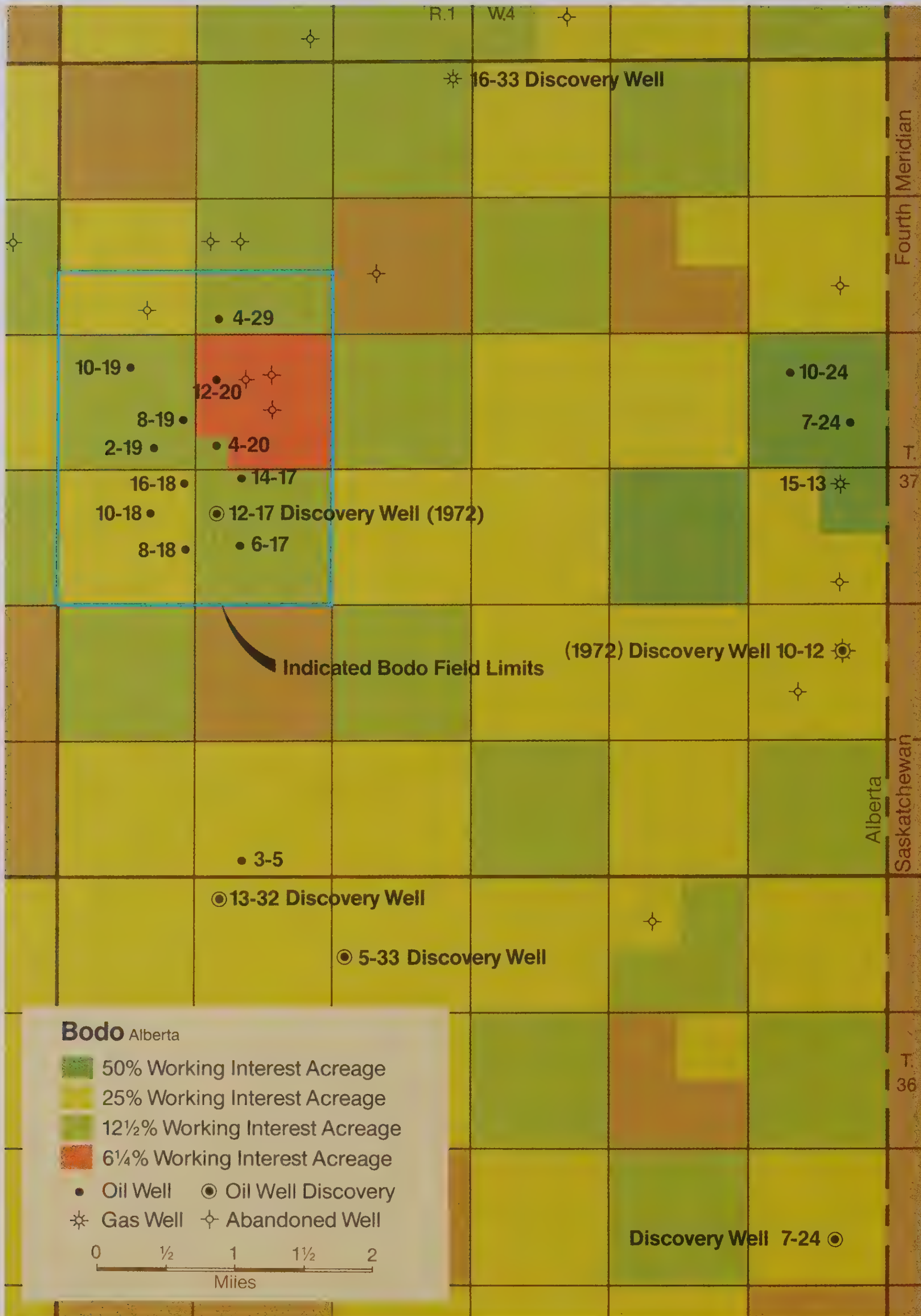
Arctic Islands

In the Arctic Islands region Canadian Reserve holds exploratory oil and gas rights to 8,970,757 acres (6,519,025 net) and has overriding royalty interests in 1,412,455 acres. (See map, page 12.)

Drilling by the industry continued at a high pace with 6 to 8 rigs active through most of the drilling season. New discoveries during 1973 include a gas well at the Wallis K-62 location on King Christian Island, a stepout gas well at the Thor Island H-28 site and a field well at Drake Point.

During the past year, Canadian Reserve participated for a 14.3% interest in the Horn River Middle Fiord J-53 well on Axel Heiberg Island. At year end this well was drilling at 6,500 feet toward a total projected depth of 6,550 feet without encountering any oil or gas shows to the depth drilled. By such participation Canadian Reserve will earn a 7.15% interest in the well and in 271,000 acres surrounding the well.





Canadian Reserve continued its farmout policy in 1973 in this expensive exploration area. Some 1,672,550 acres of rights on northern Axel Heiberg Island and Ellesmere Island were farmed out to others who are committed to explore and maintain the lands for the ensuing year. Since the vast majority of Company lands in the Arctic Islands are now farmed out, the Company's direct exploration expenditure will be minimal.

Eastern Canada

In the offshore area of Eastern Canada, Canadian Reserve holds 5,044,771 acres (1,827,094 net) of petroleum and natural gas rights. The majority of these lands, 4.8 million acres (1.7 million net) have been farmed out to a major company which will explore and maintain them for the next 3 years.

Drilling by the industry in Nova Scotia, Prince Edward Island and Newfoundland, and offshore in the Gulf of St. Lawrence, the Scotian shelf and the Grand Banks continued without notable success during 1973.

Alberta

LOBSTICK: Canadian Reserve purchased a 50% interest in a 7,680-acre drilling reservation in this area in 1973. This reservation is offset to the northwest and south by reported oil wells in the Cardium formation (see map, page 11). The Company completed a detailed seismic program in late 1973 to delineate well locations, and plans to evaluate the prospective lands by exploration drilling during the first half of 1974.

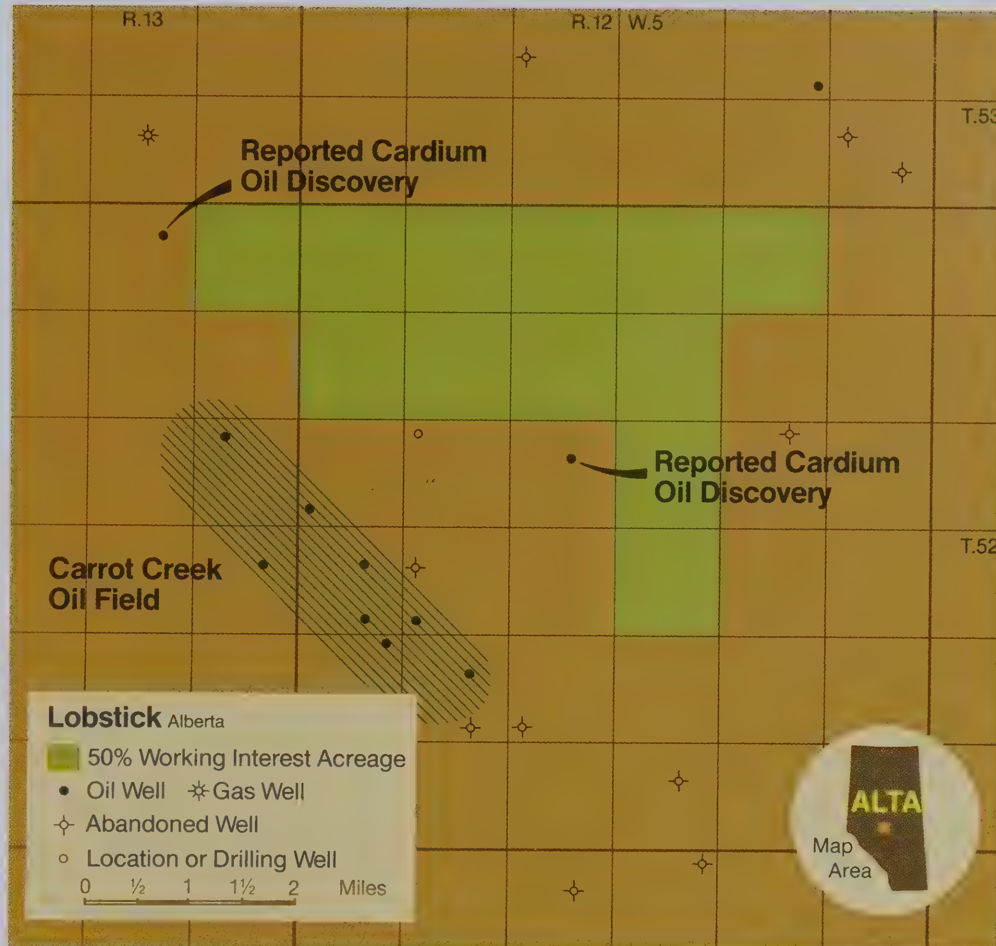
Llewellyn Bixby, Jr., Director

Heavy Minerals Exploration

In the Kamloops area of British Columbia the Company purchased a 25% interest in the Homestake Mining properties and six other heavy mineral prospects of Kamad Silver Co. Ltd. for $150,000 with the right to earn an additional 25% interest by further expenditures of $1 million for exploration and development (see map, page 13). An independent evaluation report of the Homestake properties has defined proven reserves of barite, silver, lead, zinc and copper in excess of 1 million tons.

At year-end the Company had spent some $500,000 in developing the Homestake property in preparation for underground mining operations. These expenditures earned an additional 12.5% interest, resulting in a 37.5% ownership in the mine and surrounding properties. Expenditures to date have substantially completed the work necessary to prepare for underground mining operations.

Economic studies indicate a potential income in excess of $1 million annually to Canadian Reserve's interest from the Homestake properties. Production originally scheduled for the spring of 1974 will be deferred, however, for a minimum of one year due to lack of suitable arrangements for smelting of metal sulfide concentrates, completion of feasibility studies to determine the mill size and timing of construction, and consummation of suitable marketing arrangments.



OPERATIONS

Drilling

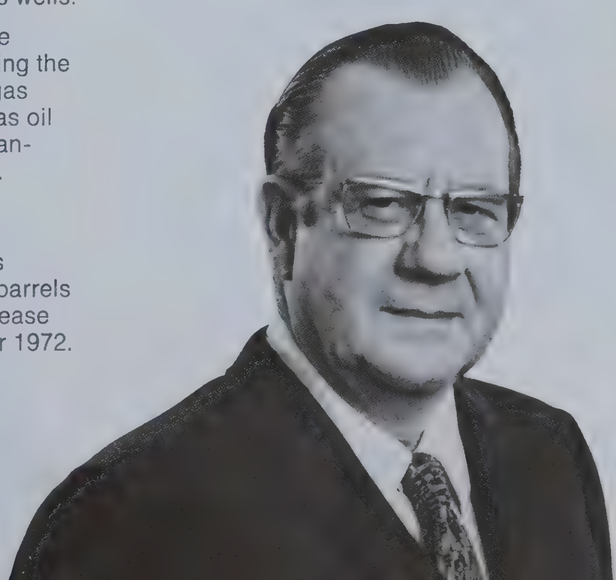
During 1973 Canadian Reserve participated in the drilling of 122 wells in Western Canada. Exploratory well completions totaled 69 wells resulting in 16 oil, 15 gas completions and 38 dry holes for a success ratio of 43.1%. Canadian Reserve's interest in the successful exploratory completions resulted in 7.6 net oil and 5.2 net gas wells.

Canadian Reserve participated in the drilling of 53 development wells during the year, equivalent to 12.7 net oil and gas wells. Of these, 46 were completed as oil wells, 2 as gas wells, and 5 were abandoned, for a success ratio of 92.9%.

Production

Net production of oil and natural gas liquids during 1973 averaged 6,531 barrels per day for a 246 barrel per day increase over the average daily production for 1972.

Net sales of gas in 1973, averaging 16.3 million cubic feet per day, decreased 11.3% from the 1972 net average sales of 18.3 million cubic feet per day. The majority of this decrease is attributable to a restriction in gas production from the East Crossfield Elkton Pool due to the concurrent oil production ruling of the Energy Resources Conservation Board. Gas sales in 1974 should show a substantial increase once the Kotcho discoveries are hooked up. The new British Columbia price of 22¢ per thousand cubic feet will also contribute substantially to gas revenues.



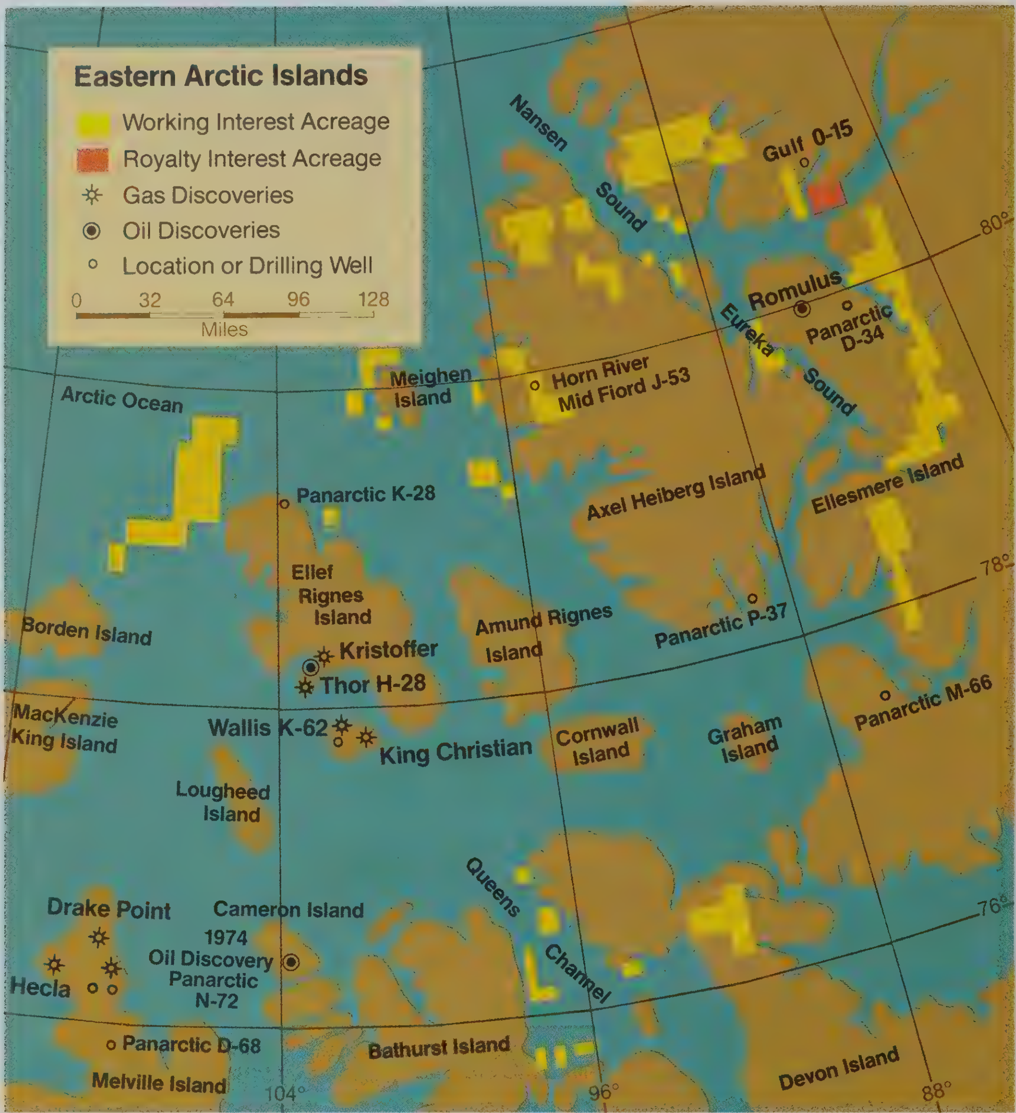
Net average sulfur production during 1973 amounted to 140 long tons per day for a decrease of 5%. The Company sold 39,645 long tons of sulfur during 1973 for a net back price of $5.49 per long ton.

The price of sulfur increased significantly late in the year when sulphur was sold by the Company for a net back price of $9.00 per long ton.

Natural Gas Processing

Canadian Reserve owns interests ranging from 0.67% to 33.3% in 7 natural gas processing plants in Alberta. The Company's most significant plant interests are in the Crossfield, East Crossfield, Sylvan Lake and Lone Pine Creek Fields of Alberta. Gas processed to the interest of Canadian Reserve from these plants was 4,848 million cubic feet in 1973 compared to 5,510 million cubic feet in 1972.

B. J. Westlund, Director



Transportation

Canadian Reserve owns a 47.5% interest in the 101-mile long Lone Rock-Kerrobert pipeline system which transports a crude oil-condensate blend from the Lloydminster area of Saskatchewan to connect with the Interprovincial Pipeline at Kerrobert for delivery to the Ontario and Chicago marketing areas.

A 2½ mile extension was added to this pipeline during the last half of 1973 to gather approximately 600-700 additional barrels per day of oil from the area.

During 1973 the Lone Rock-Kerrobert pipeline delivered 3,127,000 barrels of blend to the Interprovincial line. This averaged 8,566 barrels per day for an increase of 18% over the 1972 daily average of 7,243 barrels per day.

In Northeastern British Columbia, Canadian Reserve owns a 21.67% interest in a 72-mile pipeline which transports crude oil from the Aitken Creek, Blueberry and Inga fields to Taylor Flats for movement via other pipelines into West Coast refineries. This system, capable of handling 15,000 barrels per day, added income of approximately $62,000 net to the account of Canadian Reserve in 1973.

REGULATION

The substantial price escalation of Middle East crude oil has resulted in regulatory action in Canada, both federally and provincially. The Federal Government has taken steps to prevent the price of Canadian crude oil used domestically from escalating until at least April 1, 1974, and to increase the price of Canadian crude oil which is exported to near the international price by levying a substantial export tax. The Province of Saskatchewan has passed legislation which imposes a production tax which will have the effect of fixing the price to the producers at current levels. The Province of Alberta has established a marketing board which will make it the sole purchaser and seller of crude oil produced in Alberta from Crown lands; however, it has indicated that a part of the price increase on oil which is exported will accrue to the producer. This province has also adopted a gas royalty formula based on wellhead prices with a minimum of 22% and a maximum of 65% when the wellhead price reaches 72¢ per thousand cubic feet, and has stated that it intends to adopt a sliding scale royalty on oil based on the wellhead price.

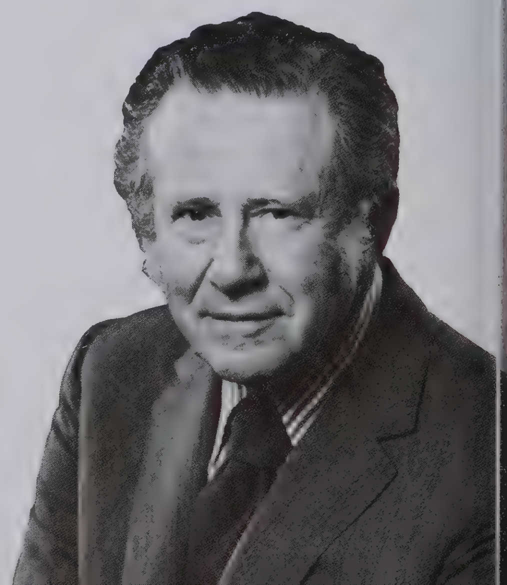
As a result of these governmental actions a producer of crude oil finds it impossible to forecast the effect, if any, which the escalating prices on the world's markets will have on the Canadian wellhead price.

Although the Province of British Columbia has imposed regulatory controls in respect to gas, the effect of this on Canadian Reserve is currently favorable because the producer will now receive substantially higher prices for gas.

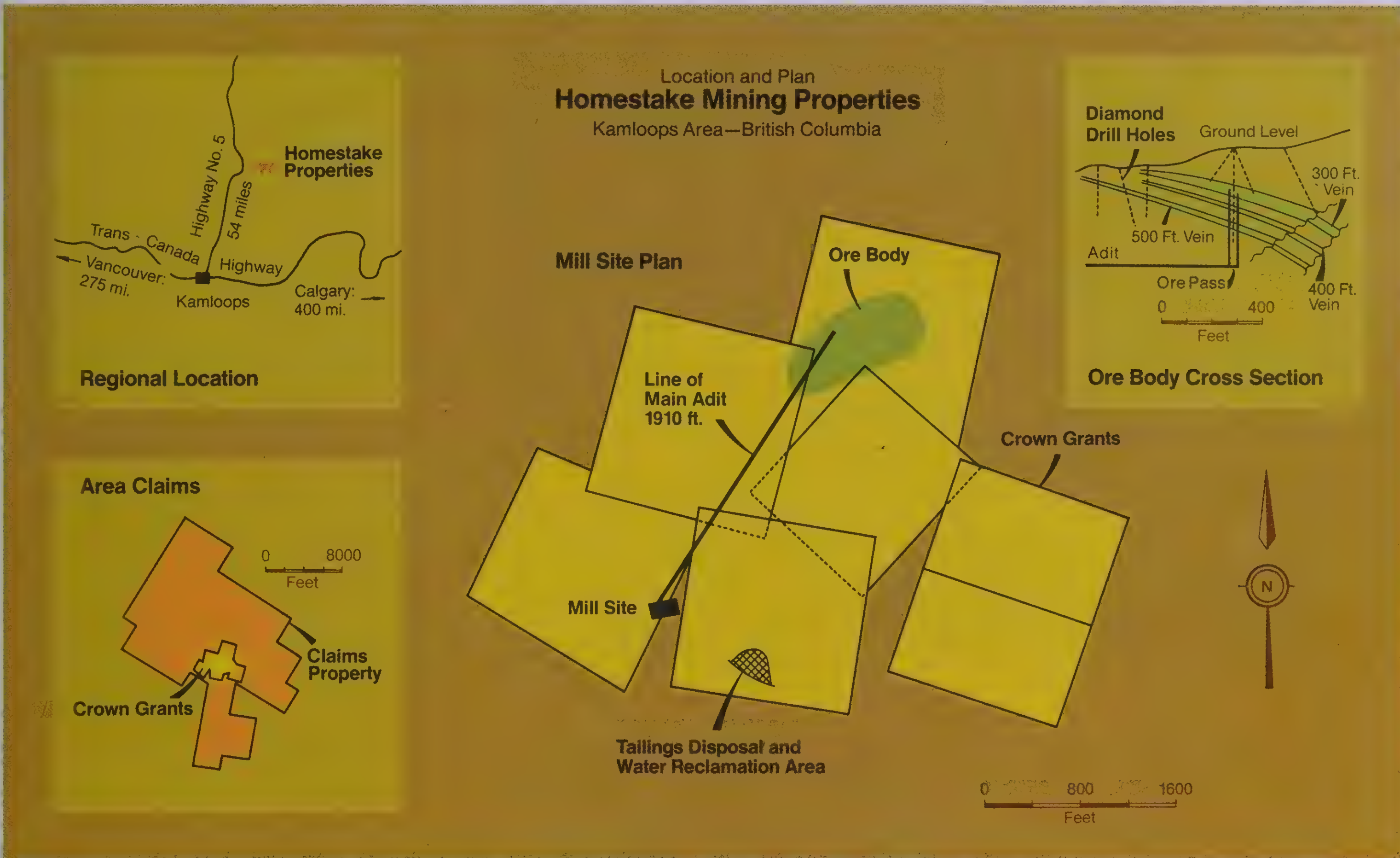
U.S. Exploration

LOUISIANA—SOUTH LAKE CHARLES AREA

The Company participated in the drilling of an exploratory well on a 1,900-acre block located in Calcasieu Parish, Louisiana. The well, designated as Lawton-Plauche #1, was drilled to a total depth of 9,985 feet and resulted in a new field



Joseph A. Ball, Director



discovery in the Marg. howei sand. Through perforations from 9,166-9,169 feet the well produced on test at a rate of 98 barrels per day of 47.2° gravity oil and 1 million cubic feet of gas per day through an 11/64" choke with 2,750 psi flowing tubing pressure. There are other productive zones behind pipe which will be perforated and produced at a later date. The Company owns a 12½% working interest in this discovery and in the 1,900 acres. Deliveries from this well commenced January 10, 1974 under a gas contract with a price of 75¢ per thousand cubic feet for the first year and 85¢ per thousand cubic feet for the second year, subject to price negotiation at that time. The oil (condensate) price is $10.05 per barrel. (See treating facilities picture on page 14.)

TEXAS—GOMEZ FIELD

In 1973 the Company acquired, through the Western Crude Oil, Inc. merger, interests in 2 successful gas wells in the Gomez Field, Pecos County, Texas.

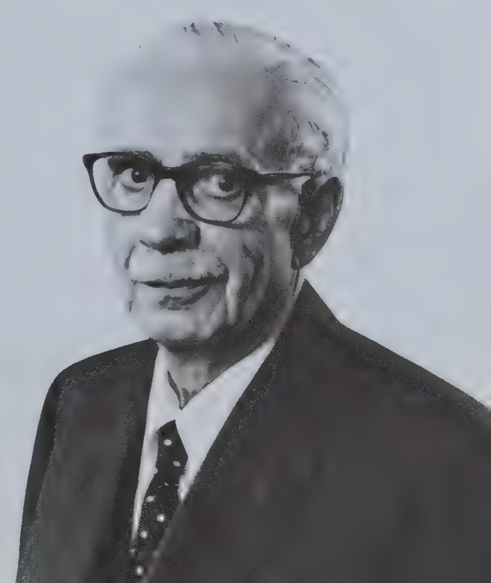
SOUTH GOMEZ UNIT #1—This significant discovery is located approximately 2 miles west of the known limits of the Gomez Field. It was completed in the Ellenberger formation flowing 15½ million cubic feet of gas per day through a ½" choke with 2,900 psi flowing tubing pressure. Reserve owns a 6.2% royalty interest in this well, plus a 5% working interest to payout, and a 2½% working interest after payout.

SOUTH GOMEZ UNIT #2—This well, a follow-up to the Unit #1 well, was completed from the Ellenberger formation flowing 23 million cubic feet of gas per day through a 48/64" choke with 2,320 psi flowing tubing pressure. The Company owns a 1.9% royalty interest in this well, plus a 10% working interest to payout and a 5% working interest after payout.

Reserve owns an additional 1100 net mineral acres in the Gomez Area in fee.

WYOMING—KITTY FIELD

During 1973 the Company participated in the drilling of 2 easterly stepouts in the Kitty Field, Campbell County, Wyoming. The "Rawhide Federal" #1 was completed in the Muddy sand, producing 240 barrels per day of 39° gravity oil and 1.3 million cubic feet per day of gas. The Company



William L. Holloway, General Counsel,
Morrison, Foerster, Holloway, Clinton & Clark, San Francisco

Natural gas treating facilities at Reserve's #1 Lawton-Plauche well, South Lake Charles Field, Calcasieu Parish, Louisiana

owns a 2½% overriding royalty before payout and a 16⅔% working interest after payout.

The "Reserve Federal" #3 was drilled as a joint venture well and was completed in the Muddy sand, at year end, flowing 365 barrels per day of 39° gravity oil. Reserve owns a 33⅓% working interest in this well.

MID-CONTINENT DIVISION

In 1973 an average of 2,236 barrels of crude oil, condensate and natural gas liquids per day and 10.5 million cubic feet of gas per day were produced and sold from Mid-Continent properties, net to the Company's interest.

Reflecting the effect of the energy shortage, the average net price per barrel of Mid-Continent crude oil sold as of December 31, 1973, was $6.20 per barrel. This figure compares with $3.19 for December, 1972.

Division activities during the year are summarized below:

New Mexico

RESERVE-ANTWEIL JOINT VENTURE: Effective October 1, 1973 the Company entered into a Joint Venture with Morris R. and Alan J. Antweil, independent oil operators of Hobbs, New Mexico. The Company's participation in the Venture is 50%. The main purpose of the Venture is to develop approximately 1,000 acres of potentially gas and gas/condensate productive lands located in the heart of the prolific South Carlsbad Field, Eddy County, New Mexico.

The Venture's first well, Saik #1, (see picture, page 1) located in the NW/4 NE/4 of Section 17, T22S, R27E, will be drilled to 12,000 feet. A northwest diagonal offset to the Saik well is now in the process of being completed as a dual producer of gas from the Strawn and Morrow reservoirs. This offset well is reported to have encountered over 70 feet of gas productive formation.

Reserve acquired its interest in the Venture by contributing drilling and development funds. The Antweils contributed the South Carlsbad gas acreage and also interests in 9 producing oil wells in the Spraberry Field, Glasscock County, Texas, and in an oil producing unit in the Lone Pine Dakota "D" Field in McKinley County, New Mexico. Formation of the Venture involved funds in excess of $3 million.

Most of the acreage to be developed by the Joint Venture is not dedicated to existing gas contracts. Thus, the gas reserves developed will be marketed at the highest price negotiable at the time of well completion. The current price for condensate is approximately $10 per barrel.

SECONDARY RECOVERY PROJECTS: Continued excellent results were derived from water injection projects operated by the Company. The Cooper Jal Unit, containing 95 wells, produced an average of 1,295 barrels per day during December 1973, as compared to 113 barrels for the same period in 1972, and the rate is continuing to increase. At South Langlie Jal, a unit containing 27 wells, December 1973 production averaged 325 barrels per day, as compared to 71 for December 1972. The Company's interest in these two units is 23.66% and 40.08%, respectively. In accordance with Federal Regulations, all oil currently being produced from these units is classified as "new oil" and the December 31, 1973 price was $9.92 per barrel. Formations responding to the water injection program include the Yates, Seven Rivers and Queens.

WESTERN DIVISION

General

Western Division crude oil production increased from 455,500 barrels in 1972 to 475,600 barrels in 1973. This resulted from acquisition of producing properties in the Rosedale Field and well stimulation and remedial work, all of which was more than sufficient to compensate for normal decline.

Wells Drilled

	Gross Wells 1973	Gross Wells 1972	Net Wells 1973	Net Wells 1972
Development:				
Producers	67	92	12.42	24.91
Dry Holes	6	8	1.05	2.17
	73	100	13.47	27.08
Exploration:				
Producers	33	21	11.49	5.28
Dry Holes	57	47	19.71	10.55
	90	68	31.20	15.83
TOTAL WELLS:	163	168	44.67	42.91

Success Ratios: (Gross)	1973	1972
Development	91.8%	92.0%
Exploration	36.7%	31.3%

Acreage and Producing Wells

	Working Interest Acreage					Royalty Acreage		Oil and Gas Wells	
		Undeveloped Acreage		Developed Acreage					
	Gross Acreage	Gross	Net	Gross	Net	Gross	Net	Gross	Net
United States									
California	14,821	3,248	3,026	11,573	3,782	2,772	75	899	101.42
Colorado	30,571	28,331	8,364	2,240	200	24,721	1,095	4	1.00
Illinois	10,206	1,551	324	8,655	74	3,814	332	308	2.62
Kansas	25,155	21,958	10,949	3,197	356	14,382	185	5	.56
New Mexico	34,621	14,319	2,213	20,302	2,853	320	5	137	21.39
Oklahoma	11,838	440	190	11,398	357	14,920	170	201	4.97
Texas	72,055	25,270	10,717	46,785	9,945	113,152	1,889	483	86.09
Utah	50,226	50,226	48,130	—	—	42,648	1,279	—	—
Wyoming	259,457	195,444	95,849	64,013	2,660	58,235	1,165	132	8.89
All Others	27,805	11,010	6,735	16,795	774	22,732	1,987	339	5.69
Total	536,755	351,797	186,497	184,958	21,001	297,696	8,182	2,508	232.63
Canada/Alaska									
British Columbia	607,355	421,314	97,795	186,041	39,399	51,524	738	146	17.76
Alberta	795,314	731,545	207,492	63,769	23,463	133,124	3,425	1,061	44.54
Saskatchewan	663,309	611,960	222,814	51,349	21,116	582,254	718	1,538	278.09
Manitoba	9,587	6,649	3,285	2,938	1,342	2,647	43	323	13.39
Northwest Territories	1,453,973	1,453,973	735,860	—	—	1,498,161	36,698	—	—
Yukon Territory	747,450	747,450	327,668	—	—	351,228	9,330	—	—
Arctic Islands	8,970,757	8,970,757	5,775,856	—	—	1,412,455	37,543	—	—
East Coast	5,044,771	5,044,771	1,618,805	—	—	—	—	—	—
Alaska	26,584	26,424	12,206	160	48	6,002	406	1	.15
Total	18,319,100	18,014,843	9,001,781	304,257	85,368	4,037,395	88,901	3,069	353.93
GRAND TOTAL	18,855,855	18,366,640	9,188,278	489,215	106,369	4,335,091	97,083	5,577	586.56

NOTE: The above includes all acreage holdings and wells owned by Reserve, including Reserve's interest in exploration programs and joint ventures. Oil and gas wells comprise all producing wells including wells which were contributed to units.

California

ROSEDALE FIELD: In 1973 Reserve acquired all of the Goldman producing interests in the Rosedale and East Rosedale Fields, San Joaquin Valley. Nine producing wells, one waste water disposal well and ten idle wells were included in the purchase. Two of the latter have been recompleted and returned to production and plans are being made to work over several additional idle wells. An extension to an existing gas line was installed at year end to provide for the processing, in nearby facilities, of gas from recompleted wells and others.

The wells purchased are presently capable of producing about 115 barrels per day of 32° gravity oil, net to Reserve's interest.

TEJON AREA: All of Reserve's interests in the Tejon-Grapevine and Tejon Hills Fields, and a portion of the North Tejon Field, now fall in the "stripper well" category. As a result of recent regulations, exempting stripper oil from controls, there has been an increase in the price paid for Tejon-Grapevine 24° gravity oil from $3.02 to $9.38 per barrel. Accordingly, Reserve's rate of net revenue from these operations has more than doubled, effective December 19, 1973.

This same beneficial stripper well treatment applies to Reserve's holdings in the Fruitvale Field, to two leases at Rosedale, and to all but one of the Company's wells in the Orcutt Field.

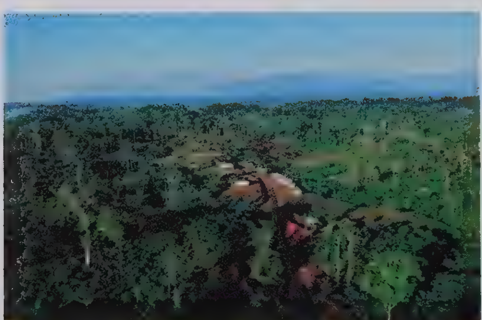
GAS FIELDS: Gas price increases were consummated in the nine California dry gas fields in which the Company has interests. These contracts resulted in a substantial increase, in all cases, in the price of gas sold, averaging 7.5¢ per 1,000 cubic feet. The new prices were effective at mid-year 1973, with a further increase provided for at mid-1974. The effect of this is to increase the Company's net income from dry gas sales, on a yearly basis, by about $100,000.

Reserve acquired additional gas production, as of June 1, 1973, when it purchased the Santa Fe Minerals, Inc. interests in the Banta Station, McMullin Ranch and Vernalis Fields.

VERNALIS FIELD: A field-wide compressor installation was completed in the latter part of the year. A subsequent deliverability test resulted in approximate doubling of the field's producibility from 6,430,000 cubic feet to 11,365,000 cubic feet per day. Reserve now owns approximately 34% of Vernalis-Banta field production.

Wyoming

As in California, the Company benefited significantly in various Wyoming fields, where certain production could be classified as "new" oil or "stripper" oil. These categories of production were commanding prices at year end approximately double the postings for what is considered "old" oil. In particular, this benefit is being realized for Reserve's interests in the Burke Ranch Unit, Skull Creek Unit, Recluse (in part), Kitty, and West Desert Springs Fields.



COLOMBIA

On November 10, 1973, drilling commenced on the first well, the Nancy #1, located on Sector Two of the Contract of Association areas in the Company's Colombia concession. Extremely high pressures were encountered at 10,085 feet accompanied by a heavy influx of medium gravity oil. This zone, near the top of the Villeta formation, is approximately 1,500 feet above the main Caballos formation of Cretaceous age.

The Colombia concession, in which Reserve has a 12½% working interest, is located at the north end of the Napo-Putomayo Basin on trend with the Lago Agrio, Sacha and Shushufindi fields of Ecuador. The venture lands consist of a Seismic Option area of 2,545,000 acres, and two "Contract of Association" areas covering 220,000 acres each.

The two Contract areas have an initial 3-year exploratory period, which may be extended an additional 3 years. The Seismic Option area requires the expenditure of $2 million in geophysical work over a two-year period, at which time the venture will have the right to select various blocks for exploratory drilling under new Contracts of Association.

During the past year the venture has shot a total of 382 miles of seismic lines on the Contract of Association areas and 300 miles of seismic lines on the Seismic Option area. The remaining required seismic work on the Seismic Option area will be conducted in 1974.

It is anticipated that at least two additional exploratory wells will be drilled on the concession during 1974. Results of the seismic work completed to date indicate the presence of a number of features which warrant drilling.

Left, upper, a long range view of the jungle setting of the Nancy No. 1 drillsite; and *below,* a close-up view of the drillsite.
Right, the drilling rig for the Nancy No. 1 well.

Western Crude Oil, Inc.

Western Crude Oil, Inc. continued to successfully expand its sales and service operations during 1973, its first year as a member of Reserve's group of companies.

Crude oil purchasing, transporting and marketing activities enjoyed increasing volumes and continued diversification. By virtue of its ability to trade crude oil throughout the United States, Western Crude assisted in obtaining some new crude oil supplies for Mohawk's refining operations in California.

Western Crude's liquefied natural gas products sales were expanded substantially, and the outlook for continued growth in this area through its subsidiary, Pontotoc Oil Company, appears to be most promising.

During 1973 Western Crude's principal pipeline subsidiary, Wesco Pipe Line Company, completed the expansion and renovation of its Poplar system in northeastern Montana. Also during the year extensive remedial and maintenance work was accomplished on other of the Company's pipeline systems in order to further increase safety, capacity and efficiency throughout the Company's 1,100-mile network.

Western Crude has acquired a 25% interest in Texoma Pipe Line Company which is beginning construction of a $97 million 30-inch diameter pipeline from Beaumont, Texas to Cushing, Oklahoma. This 470-mile common carrier crude oil pipeline system will have an initial delivery capability of approximately 425,000 barrels per day, and is expected to be in operation by January 1975. It will provide much needed facilities to transport crude oil from the Gulf Coast to the interior of the United States, thus permitting inland refiners the opportunity to receive offshore deliveries on a basis competitive with coastal refiners. Texoma's pipeline should allow for increased utilization of these refineries as well as permit expansion of existing refineries or construction of required new refining capacity within the inland portion of the United States.

Cortlandt S. Dietler, President,
Western Crude Oil, Inc.

Effective January 1, 1974 Western Crude Oil was able to increase its ownership in Butte Pipe Line Company from 9% to 19%. As Western Crude is the largest single source of oil movement through the Butte system, the purchase of the additional stock interest in this company is of distinct significance. Butte's northernmost terminal connects to Wesco Pipe Line's Poplar system in Montana which, in turn, connects to Wascana Pipe Line's system from Canada to Montana in which Western Crude owns a one-third interest.

In December of 1973, Western Crude Oil, Inc. agreed to a 40% joint venture participation in the acquisition of a modern refining complex near Grand Junction in western Colorado. The significance of this expanded operation for Western Crude is enhanced by the fact that the facilities purchased are of recent design, are capable of reasonable expansion and are located in an area which, by all yardsticks, is expected to grow rapidly and extensively in both population and industrial development. It is the only refinery of significance between Denver and Salt Lake City—a distance of 500 miles—and is located in such a manner that when commercial shale oil production is accomplished, it can most competitively and logically receive shale oil for processing into finished products.

A recent sale of shale leases by the Bureau of Land Management in the area of Rifle, Colorado indicates the high priority placed on shale development and thus further attests to the timeliness and propriety of this new venture. Included with the 10,000 barrel per day refinery is a 72-mile pipeline which further facilitates the economic and efficient delivery of raw materials to the refinery.

On the international scene, Western Crude's subsidiaries, Wesco International, Inc. and Easco, S.A., dramatically increased their total volume of operations. During 1973 overseas offices were opened in Geneva, London and Rotterdam. In February of 1974 a Beirut office was also established. While Wesco International and Easco, S.A. import some crude oil and finished petroleum products into the United States, they conduct a very substantial portion of their growing trading, processing and shipping business throughout the Eastern Hemisphere.

Gross revenues for Western Crude Oil, Inc. and its subsidiaries for 1973 increased by 48.1%. This extraordinary increase was primarily the result of higher sales volume for 1973 as a direct outgrowth of Western Crude's continually expanding and diversifying areas of operations. Capital expenditures for 1973 amounted to $3.5 million. The Company expects capital expenditures for 1974 to amount to approximately $4.2 million.

Because world conditions continue to remain unstable, particularly in the Middle East, and with the advent of a multitude of new governmental regulations incidental to the anticipated shortfall of petroleum-supplied energy, it is difficult to provide any thoroughly definitive predictions for fiscal 1974. Nevertheless, because of the unique position enjoyed by Western Crude Oil, Inc. and its varied spectrum of activities, both nationally and internationally, it appears that the Company will be able to continue its growth and further increase its sales and service capabilities in a satisfactorily profitable manner.

Well aware of its obligations to safely and efficiently gather and distribute crude petroleum and petroleum products, Western Crude Oil, Inc. will continue to meet the challenge of the times as a responsible corporate tax-generating entity.

Opposite page, left to right:

View of pumping facilities located at the Regina, Saskatchewan, station of Wascana Pipe Line.

Close-up view of electrically-operated valves and pumping facilities at Wesco Pipe Line Company's Glendive, Montana, station.

This page, top to bottom.

Crude oil transport unit typically used by Western Crude Oil in the state of Michigan.

Pump and manifold facilities at Feldman station of Wesco Pipe Line Company's Panotex system in Oklahoma.

Panoramic view of typical pumping and storage facilities of Wesco Pipe Line Company at the Glendive, Montana, station of the Poplar system.

Mohawk Petroleum Corporation, Inc.

Mohawk Petroleum Corporation, Inc., a wholly-owned subsidiary of Reserve operating exclusively in the fields of oil refining and petroleum product marketing, has for the fourth consecutive year achieved higher levels of revenues and profits. In the marketing of gasoline, the company's principal product, sales increased to 165,103,164 gallons, a 21% increase over 1972. This percentage, when added to previous gains, has resulted in a cumulative 95% gasoline sales increase in the 4 years since Mohawk became a subsidiary of Reserve. The 1973 increase was achieved by Mohawk's three marketing groups—the Northern Division headquartered in San Francisco, the Central Division in Bakersfield, and the Southern Division in Los Angeles—in the face of unusually tight supply conditions and in full compliance with governmental allocation programs.

When it became evident early in 1973 that rapidly increasing demand for motor gasoline in Mohawk's marketing areas would quickly outstrip available supplies, the Company immediately deferred budgeted marketing investments which had been programmed late in 1972. In order to assure continuity of supply to independent distributors and dealers dependent on Mohawk for survival, the Company closed nine Company operated service stations and terminated lease arrangements on five marginal stations. The Company is gratified that supplies of gasoline available to it have made possible continued profitable operations for its independent customers during this difficult year.

At year end, Mohawk products were being marketed through 270 retail outlets (down from 307 in 1972) comprising 159 Mohawk branded service stations and 111 outlets selling Mohawk products re-branded to other trade names, plus approximately 100 jobbers, commercial customers and other accounts located in 157 cities and towns in California and Arizona. Twenty-three of the service stations are company-operated with the balance being operated by independent lessees and dealers.

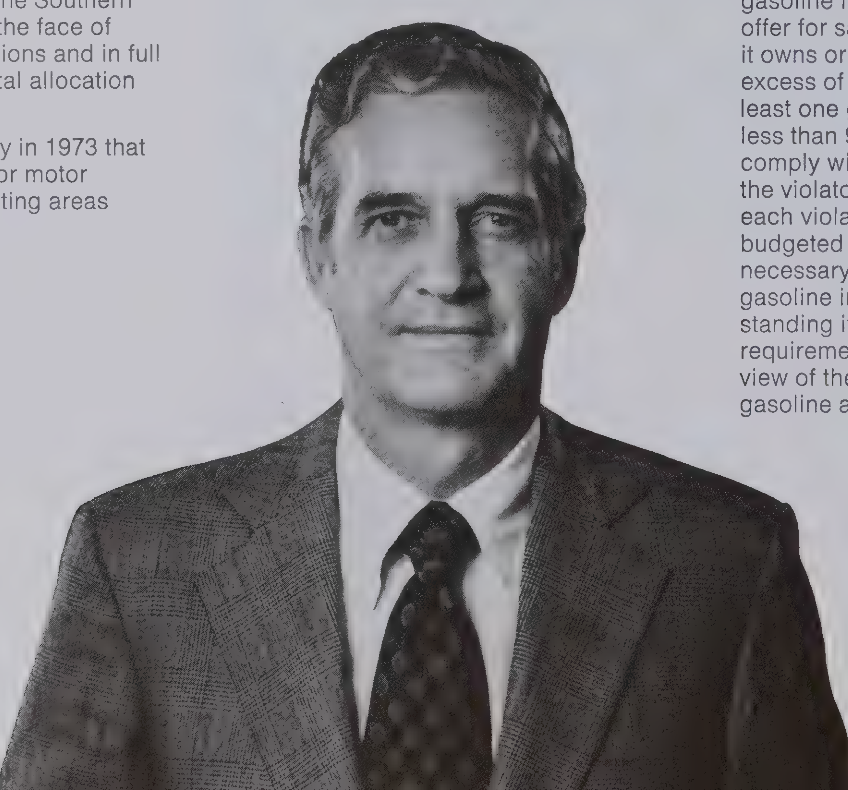
As a result of Mohawk's successful marketing expansion during the past 4 years, production of gasoline at the Bakersfield refinery now represents approximately 53% of total sales. The difference between sales requirements and production is acquired from other refineries in California through purchase or exchange for other products. It is anticipated that such arrangements will be continued in 1974.

During 1973 Mohawk's refinery processed 5,877,100 barrels of high gravity San Joaquin Valley crude oil (16,102 barrels per day), a slight decrease from 1972 levels. This oil was obtained under purchase contracts with a major oil company, numerous independent oil producers and the United States Navy. In addition, Mohawk purchased United States Government royalty oil from Alaska, the Outer Continental Shelf in the Santa Barbara Channel, and certain on-shore leases in California administered by the U.S. Geological Survey.

Anticipating increased supplies of crude oil made available to Mohawk at the end of 1973 by its affiliate, Western Crude Oil, Inc., modifications were made during the year to Refinery Crude Unit #4 increasing its capacity 1,600 barrels per day. Early in 1974 rehabilitation work was completed on the existing Crude Unit #2, which has been shut-in since September 1963. On a 48-hour test run in January, 1974, the unit processed crude oil at the rate of 3,760 barrels per day, thereby achieving operating status for that unit and raising total refining capacity to 22,100 barrels per day.

During 1973, Mohawk received licenses to import 13,304 barrels per day of foreign crude oil, a 70% increase over 1972. Accordingly under present regulations which provide for increased fee-free import licenses in behalf of expanded or reactivated crude capacity, Mohawk anticipates receiving licenses to import in excess of 17,800 barrels per day during 1974.

Existing regulations promulgated by the Environmental Protection Agency require that commencing July 1, 1974 every gasoline marketer in the United States must offer for sale at each service station which it owns or controls and which pumps in excess of 200,000 gallons per year at least one grade of unleaded gasoline of not less than 91 Research Octane. Failure to comply with this requirement will subject the violator to a fine of $10,000 per day for each violation. Accordingly, Mohawk has budgeted funds to the investments necessary to store and dispense unleaded gasoline in each of its stations, nothwithstanding its considered belief that the requirement is unnecessary and onerous in view of the limited market for unleaded gasoline anticipated to exist at that time.



Malcolm McDuffie, President,
Mohawk Petroleum Corporation, Inc.

Nighttime view of Mohawk Bakersfield Refinery

In addition, the Environmental Protection Agency on December 6, 1973 promulgated regulations requiring refiners to phase down the lead content of leaded gasoline commencing January 1, 1975 achieving a maximum lead content of 0.5 gram per gallon after January 1, 1979, i.e. to the level of "unleaded gasoline". Mohawk believes that this regulation is unnecessary, arbitrary and unlawful, and, because it requires more crude oil to make each gallon of gasoline without lead, is counter-productive to the energy shortage. Accordingly, Mohawk has joined the National Petroleum Refiners Association and other refiners in an action before the United States Court of Appeals for the District of Columbia against the Environmental Protection Agency asking that the court remand this regulation.

Since these regulations as they now exist will require Mohawk ultimately to develop a completely unleaded capability in the manufacture of gasoline, preliminary engineering studies have been completed indicating the necessity for construction of new refinery conversion units capable of producing unleaded gasoline in quantities sufficient to meet Mohawk's normal market demand growth but requiring only 1973 levels of crude supply. It is anticipated that the recommendations contained in these studies will be acted upon during 1974. In connection with this proposed program of refinery modernization, Mohawk during 1973 purchased 69 acres of land immediately adjoining and contiguous to its existing refinery which had been under lease to the Company for over 25 years.

Effective January 15, 1974, Mohawk commenced operations under mandatory regulations issued by the Federal Energy Office pursuant to the Emergency Petroleum Allocation Act of 1973. These regulations control the supply and distribution of crude oil processed at the refinery, provide for controlling the yield of products produced by the refinery, and control the allocation and sale of Mohawk's principal products, gasoline and diesel oils. Incorporated in the regulations are strict price controls affecting both wholesale prices charged by the refinery and retail prices charged by Company operated service stations. Under the regulations as they now exist, Mohawk's supply and distribution patterns both of crude oil and products should remain reasonably constant throughout 1974.

Operating Highlights 1973

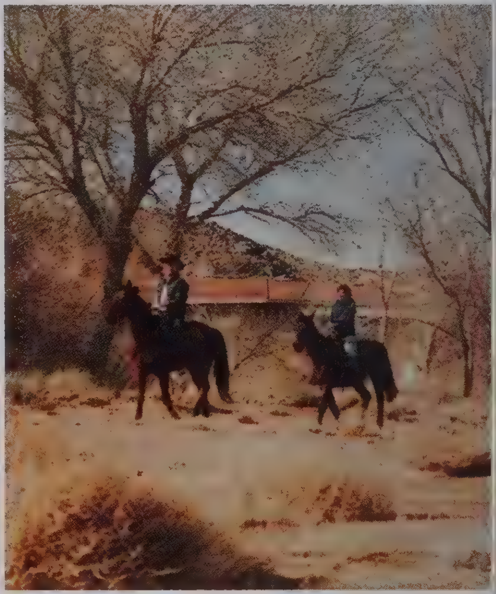
Refinery Thruput	5,877,100 Barrels	16,102 Barrels per Day
Gasoline Sales	165,103,164 Gallons	13,758,597 Gallons per Month
Diesel & Stove Oil Sales	53,559,612 Gallons	4,463,301 Gallons per Month
Jet Fuel Sales	10,478,112 Gallons	873,176 Gallons per Month

Apple Valley Ranchos

Revenues generated from the operations of Apple Valley Ranchos activities totaled $4.2 million in 1973, compared with $5.0 million realized in 1972. Revenues primarily represent income from the sale of subdivided property and also include commission income from the sale of property owned by others, interest received on land sales contracts, revenues from hotel operations and public utility water sales. The 1972 revenues also included the cash sale of two major shopping center sites, one of which is currently under construction. In subdivision activity, the Apple Valley Ranchos organization is in the final stage of development of two hillside subdivisions, comprising approximately 390 large-sized view lots on 255 acres. Both subdivisions are close to shopping areas and schools and will have paved streets and underground electric, gas, water and telephone service available prior to sale to the public.

Apple Valley Ranchos owns and has operated the Apple Valley Inn for many years. The Inn is a widely-known resort hotel and attracts guests from many parts of the country, particularly from California, and the neighboring states of Nevada and Arizona. The Valley offers a variety of activities to visitors, including swimming, horseback riding, tennis, and golf on the beautiful Apple Valley Country Club 18-hole championship golf course. The mild climate and picturesque surroundings are within 100 miles of Los Angeles, and it is an easy roundtrip drive on less than a tankful of gasoline. With the numerous attractions available it is anticipated that the area will grow in popularity.

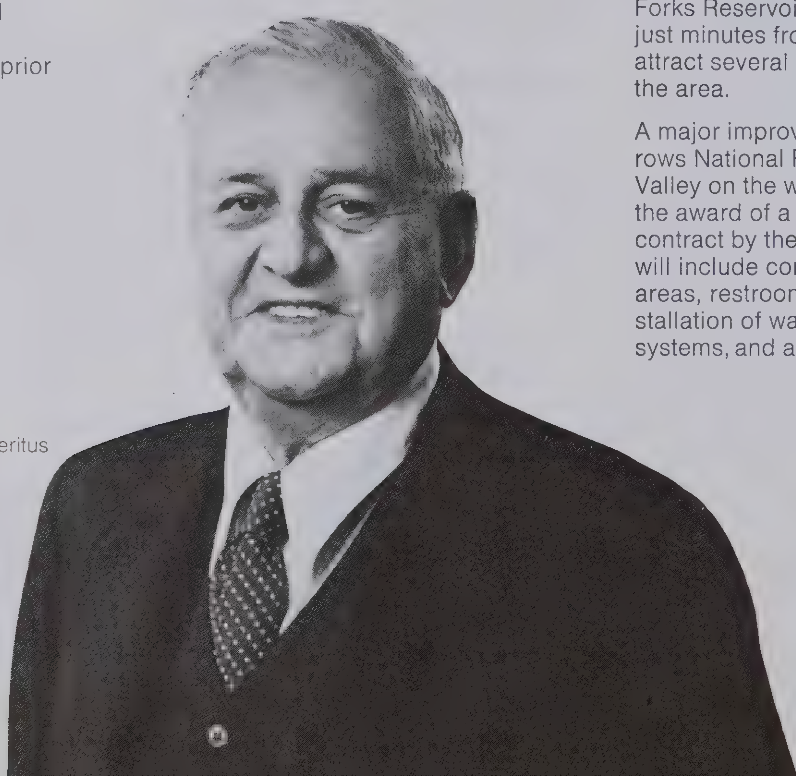
Apple Valley Ranchos Water Co., a public utility water company owned and operated by your Company, placed meters for 172 new residences and business buildings in 1973, which is the fifth consecutive year Apple Valley has experienced increased construction activity. The increase was more than 15% in 1973 over 1972. Your Company is not engaged in the construction business at this time; however, the stable economic pattern created by the new families and new businesses has a favorable impact on your Company's extensive real estate holdings in the area.



During 1973, two business complexes were constructed in the Desert Knolls area of Apple Valley, providing quarters for a new dress shop, beauty salon, engineer and contractor, as well as a plumbing shop, flooring company and new quarters for the Apple Valley Chamber of Commerce. Other new businesses added in the year include an auto body shop, a second neighborhood market, several gift shops and an Artist's Center.

The Valley is the northern gateway to the San Bernardino National Forest, which offers an extensive recreational area, including skiing, boating, fishing and camping. San Bernardino County has extended the facilities at Cedar Springs Dam and Silverwood Lake, as well as the Mojave Forks Reservoir Dam. All of these sites are just minutes from Apple Valley, and will attract several million people per year to the area.

A major improvement at the Mojave Narrows National Park, adjacent to Apple Valley on the west, has been assured with the award of a $422,900 construction contract by the county. The improvements will include construction of roads, parking areas, restrooms, gatehouses, and installation of water, sewer and electrical systems, and also the planting of 625 trees.



Newton T. Bass, Chairman of the Board, Emeritus

Panorama looking east, in the middle of January, from Hilltop House. In the foreground is the widely known Apple Valley Inn

Golfers enjoying a sparkling day on the Apple Valley course. *At left:* Horseback riding is a twelve month sport and social activity in the Valley.

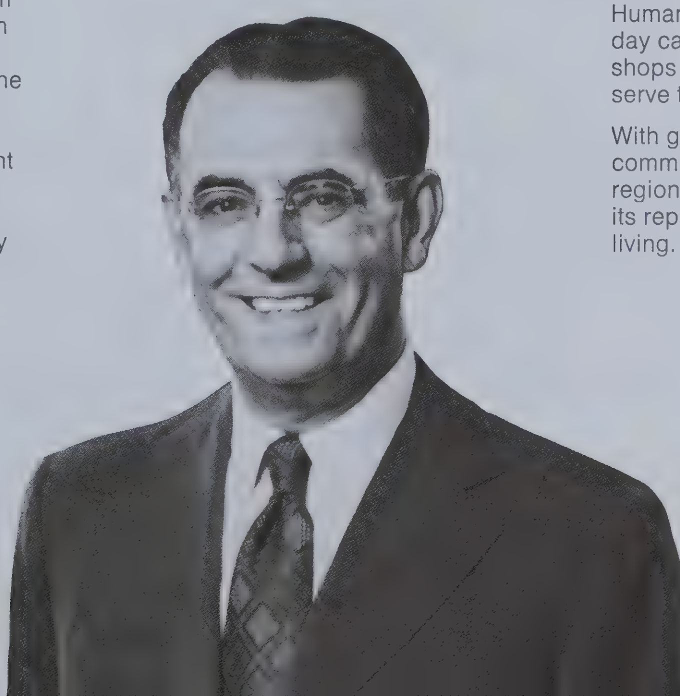
Final plans for a new surgical pavilion at Saint Mary's Desert Valley Hospital have received approval of the Board of Trustees, and ground will be broken in the near future. The new project is estimated to cost $2 million, and will provide four surgical suites, a recovery room, delivery room and all required service areas. Expansion will also take place in the laboratory, radiology, pharmacy and dietary units. The growing needs of the Apple Valley community have influenced the Board of Trustees to continue with the enlargement of hospital facilities, and the capacity for surgical services will be doubled. Plans call for the latest in equipment and safety features.

FHM Investment Corporation has started construction of a full service shopping center in the "Village" commercial area of Apple Valley. It is expected that a grand opening will take place in late spring. The completion of this major shopping center will further enhance the total community concept that has been formulated and originated by the management of the Apple Valley Ranchos Division.

To further provide for the growth created by new families moving into the Valley, Trustees of the School District have unveiled plans to add a new wing at the Apple Valley Junior High School and to construct additional facilities at Apple Valley Senior High School at an aggregate cost of approximately $1.9 million.

On the western boundary of the Valley, Victor Valley College is growing. Enrollment has increased at the rate of 10% per year, and in the fall of 1973 reached a total of over 2,600 full and part-time students. The college is served by a staff of administrators, 58 full-time instructors, 59 part-time instructors and a staff of 40 non-teaching and classified employees. The college has established an extension campus at the nearby George Air Force Base, a Human Services Center, and a complete day care center, and offers special workshops and other training programs to serve the community.

With growing commercial, recreational and community activities, the Apple Valley region has continued each year to enhance its reputation as an area for enjoyable living.



Walter E. Cramer, Jr., Vice President

Consolidated Balance Sheet

December 31, 1973 and 1972

Assets

	1973	1972
	(In Thousands)	
Current assets:		
Cash—including short-term investments in 1973 of $25,672,000	$ 31,702	$ 24,369
Accounts receivable	70,003	23,555
Installment contracts, commissions and notes receivable, net	928	929
Inventories	9,504	5,243
Prepaid expenses	1,132	1,195
Total current assets	113,269	55,291
Long-term receivables and investments:		
Installment contracts, commissions and notes receivable, net	4,762	5,142
Undeveloped land and other investments, at lower of cost or market	2,418	1,970
	7,180	7,112
Properties, at cost:		
Oil and gas properties	84,753	80,804
Refining, manufacturing and distributing facilities	30,626	29,670
Commercial and other properties	6,880	6,838
	122,259	117,312
Less accumulated depletion and depreciation	47,984	45,759
	74,275	71,553
Other assets, at cost less amortization	1,819	1,073
	$196,543	$135,029

Liabilities and Shareholders' Equity

	1973	1972
Current liabilities:		
Notes payable, current portion	$ 2,150	$ 3,895
Accounts payable and accrued liabilities	78,861	35,297
Refined oil products due under exchange agreements	103	1,240
Income taxes payable	4,664	231
Total current liabilities	85,778	40,663
Notes and other long-term payables	16,095	16,643
Deferred income taxes	3,214	1,435
Minority interest	4,477	2,903
Shareholders' equity:		
Capital stock:		
Convertible preferred stock, $25 par and involuntary liquidating value; authorized 400,000 shares; 1973—issued 310,134 shares (including 2,558 treasury shares)	7,753	7,769
Common stock, $1 par value; authorized 15,000,000 shares; 1973—issued 12,278,867 shares (including 7,460 treasury shares)	12,279	11,923
Capital in excess of par value	22,559	21,705
Retained earnings	44,445	32,040
Treasury stock, at cost; 1973—2,558 shares Series B preferred shares and 7,460 common shares	(57)	(52)
Total shareholders' equity	86,979	73,385
	$196,543	$135,029

See accompanying Financial Review and Summary of Accounting Policies.

Consolidated Statement of Income and Retained Earnings

Years ended December 31, 1973 and 1972

	1973	1972
	(In Thousands)	
Revenues:		
Petroleum product sales	$398,724	$252,805
Interest and dividend income	2,029	1,122
Real estate and other income	5,254	5,273
	406,007	259,200
Costs and expenses:		
Cost of sales and operating expenses	362,888	235,058
Selling and administrative expenses	12,314	9,707
Depletion, depreciation and abandonments	9,187	6,208
Interest expense	1,762	1,366
Minority interest	1,312	235
Federal, state and foreign income taxes	8,211	1,922
	395,674	254,496
Income before extraordinary credits	10,333	4,704
Extraordinary credits	2,000	1,224
Net income	12,333	5,928
Retained earnings, beginning of year	32,040	26,536
Income of pooled company, three months ended December 31, 1972	495	—
Dividends paid on preferred stock	(423)	(424)
Retained earnings, end of year	$ 44,445	$ 32,040
Per share of common stock: (in dollars)		
Income before extraordinary credits	$ .81	$ .36
Extraordinary credits	.16	.10
Net income	$ .97	$ .46

Consolidated Statement of Changes in Financial Position

Years ended December 31, 1973 and 1972

	1973	1972
Source of funds:		
Operations:	(In Thousands)	
Income before extraordinary credits	$ 10,333	$ 4,704
Items not involving working capital		
Depletion, depreciation and abandonments	8,909	6,208
Provision for deferred income tax and income tax offset by extraordinary credits	3,766	976
Other (including minority interest)	1,388	178
	24,396	12,066
Extraordinary credits less items not involving working capital	—	810
Total from operations	24,396	12,876
Collections on long-term notes receivable	429	716
Proceeds from sales of stock and note conversions by subsidiaries	1,462	151
Proceeds from loans	19,488	2,028
Proceeds from sale of properties	2,537	1,783
Operations of pooled company, three months ended December 31, 1972	801	—
Other	74	349
	49,187	17,903
Disposition of funds:		
Additions to properties	14,249	8,121
Principal applications to production payments	—	2,623
Payments and other decreases in long-term liabilities	20,067	3,554
Additions to investments and other assets	1,463	—
Additions to long-term notes receivable	117	1,095
Dividends paid on preferred stock	423	424
Other	5	422
	36,324	16,239
Increase in working capital	$ 12,863	$ 1,664

See accompanying Financial Review and Summary of Accounting Policies.

Financial Review

Earnings and Revenues. Reserve achieved record results in 1973. Income before extraordinary credits amounted to $10,333,000, equal to $.81 per share on the 12,271,018 average common shares outstanding during the year. This is an increase of 125% per share over 1972 income before extraordinary credits of $4,704,000 or $.36 per share on the average common shares then outstanding.

Net income in 1973 amounted to $12,333,000 ($.97 per share) and included an extraordinary credit of $2,000,000 ($.16 per share). In 1972, Reserve's net income amounted to $5,928,000 ($.46 per share) and included extraordinary credits of $1,224,000 ($.10 per share).

Reserve's 1973 revenues also reached a record level and amounted to $406,007,000, an increase of 57% over revenues of $259,200,000 recorded in 1972.

All of the 1972 figures noted above have been restated to reflect the April, 1973, merger of Western Crude Oil, Inc., of Denver into Reserve. This important transaction was accomplished through the issuance of 2,943,058 common shares of Reserve and has been accounted for as a pooling of interests.

Changes in Financial Position. Internally generated funds from your Company's operations amounted to $24,396,000 in 1973 and compare with funds so generated of $12,876,000 in 1972. Other funds provided included $19,488,000 of proceeds from loans. Disposition of funds included $14,249,000 for additions to properties and $20,067,000 for payments and other decreases in long-term liabilities.

Working Capital amounted to $27.5 million at the end of 1973, and compares with $14.6 million at the end of 1972. Accounts receivable and accounts payable increased significantly at the end of 1973 due to higher sales volume in the fourth quarter and increased prices of crude oil and petroleum products. The changes in the various elements of working capital are as follows:

	1973	1972
	(In Thousands)	
Increase (decrease) in current assets:		
Cash	$ 7,333	$15,190
Accounts receivable	46,448	7,661
Installment contracts, commissions and notes receivable	(1)	160
Inventories	4,261	107
Prepaid expenses	(63)	(162)
	57,978	22,956
Increase (decrease) in current liabilities:		
Notes payable, current portion	(1,745)	1,446
Accounts payable and accrued liabilities	43,564	19,085
Refined oil products due under exchange agreements	(1,137)	1,240
Income taxes payable	4,433	(479)
	45,115	21,292
Increase in working capital	$12,863	$ 1,664

Installment Contracts, Commissions and Notes Receivable. These receivables totaled $5,690,000 at the end of 1973 compared with $6,071,000 at the end of 1972, after allowance for loss ($125,000 in 1973; $114,000 in 1972) and deferred profit on residential land sales contracts and commissions receivable ($4,691,000 in 1973; $5,374,000 in 1972). Annual maturities approximate $1,575,000 in 1974 and decline approximately $80,000 per year to $1,200,000 in 1978.

Inventories at the end of 1973 and 1972 are as follows:

	1973	1972
	(In Thousands)	
Petroleum products and sulfur	$7,308	$2,862
Subdivided land, principally under development	1,551	1,482
Materials and supplies	645	899
	$9,504	$5,243

Notes and Other Long-Term Payables. At December 31, 1973, long-term debt amounted to $16,095,000, a decrease of $548,000 from the $16,643,000 payable at December 31, 1972. Long-term debt consisted of the following:

	1973	1972
	(In Thousands)	
Note payable to bank at ½% above prime, due $250,000 quarterly through 1975 and $500,000 quarterly in 1976 and 1977	$ 5,000	$ 6,000
Note payable to bank at ¾% above prime, due in equal quarterly installments from 1975 through 1980	6,500	2,438
Production loan at ½% above prime, due through 1976	2,090	1,501
10% subordinated notes	—	2,147
Non-recourse note, secured by refinery	—	1,547
Other	2,505	3,010
	$16,095	$16,643

Robert E. Aberley, Vice President and Treasurer

The bank loan agreements require, among other things, the maintenance of minimum levels of working capital and net worth and prohibit the payment of cash dividends on Reserve's common stock. The prime rate applicable to both bank notes was 10% at December 31, 1973. The note payable to bank at ¾% above prime is a line of credit that cannot exceed $10,000,000.

The aggregate amounts of minimum maturities of long-term debt are as follows: 1974 - $2,150,000; 1975 - $3,186,000; 1976 - $4,151,000; 1977 - $3,827,000; 1978 - $1,462,000; and thereafter - $3,469,000.

At December 31, 1973 Reserve and its consolidated subsidiaries were contingently liable for indebtedness of affiliates and others of approximately $8,000,000.

Stock-Option Plans. Reserve has several stock-option plans for officers and key employees, approved by stockholders at various times, under which options may be granted at the market price at the date of grant, but are not exercisable until at least one year after date of grant. Options expire five years after date of grant. At December 31, 1972, options were outstanding for 222,500 shares of the Company's common stock and 89,500 shares were available for the granting of additional options. During 1973, options for 90,798 shares were granted and options for 8,000 shares were cancelled. At December 31, 1973, options were outstanding for 305,298 shares at prices ranging from $5.45 to $15.375 per share, an aggregate of $2,605,262. At that same date options for 247,998 shares were exercisable and 40,200 shares were available for the granting of future options.

At December 31, 1972, Western Crude Oil, Inc. stock options were outstanding for 266,514 of its shares, of which 30,000 shares were exercised and 178,060 shares were cancelled prior to the merger date. The Western options for 58,454 shares outstanding at the merger date were cancelled and options on 33,498 shares of Reserve were issued in their place. An additional 33,498 common shares were reserved for issuance in connection with these options.

In addition, Canadian Reserve has a stock option plan under which options are granted at 90% of market value at date of grant, become exercisable in annual 20% increments beginning one year after date of grant, and expire ten years after the date granted. At December 31, 1973, options were outstanding for 174,000 shares of Canadian Reserve common stock (issued 35,500 in 1973, 138,500 in 1972 and prior) at prices ranging from $3.91 to $4.95 per share, an aggregate of $821,000, of which 49,900 were exercisable, and 21,100 shares were available for the granting of future options. During 1973, options for 4,900 shares were exercised and 17,100 were cancelled.

Capital Stock. Reserve has four series of 5½% cumulative, convertible, voting (except Series C), preferred stock. Shares issued as of December 31, 1973 follow: Series A - 23,638, Series B - 103,306 (includes 2,558 treasury shares), Series C - 9,600 and Series D - 173,590. Such shares are convertible into common stock at various rates and are callable by the Company at various times and at amounts up to 106% of par value.

Regular quarterly dividends were paid in 1973 on the four issues of preferred at the rate of $1.375 per share.

During 1973, 623 shares of preferred stock (62 in 1972) were converted into 1,580 shares of common stock (164 in 1972). Also during 1973 but prior to the merger date, Western Crude Oil issued 588,000 of its common shares as a result of note conversions. At December 31, 1973, 1,099,340 shares of common stock were reserved for issuance as follows: 638,190 shares for conversion of preferred stock; 345,498 shares in connection with stock options; and 115,652 shares in connection with warrants arising out of 1969 acquisitions, exercisable at $12.97 per share through September 15, 1974.

Capital in Excess of Par Value. In 1973, Canadian Reserve sold, under a stock purchase plan, 10,418 (11,853 in 1972) shares of its common stock to certain employees for $10,418 ($11,853 in 1972) and charged $54,000 to expense in 1973 and 1972. As a result, Reserve increased capital in excess of par value by $40,000 ($25,000 in 1972). Capital in excess of par value was also increased by $13,000 as a result of exercise of Canadian Reserve stock options, by $278,000 upon issuance of Canadian Reserve shares for interests in oil and gas properties, by $14,000 ($1,000 in 1972) as a result of conversions of Reserve preferred stock, by $398,000 ($2,000 in 1972) as a result of the conversion of Western Crude Oil notes, and by $111,000 ($67,000 in 1972) as a result of exercise of Western's stock options. In addition, capital in excess of par value at the beginning of 1972 was retroactively increased by $4,623,000 as a result of the merger with Western Crude.

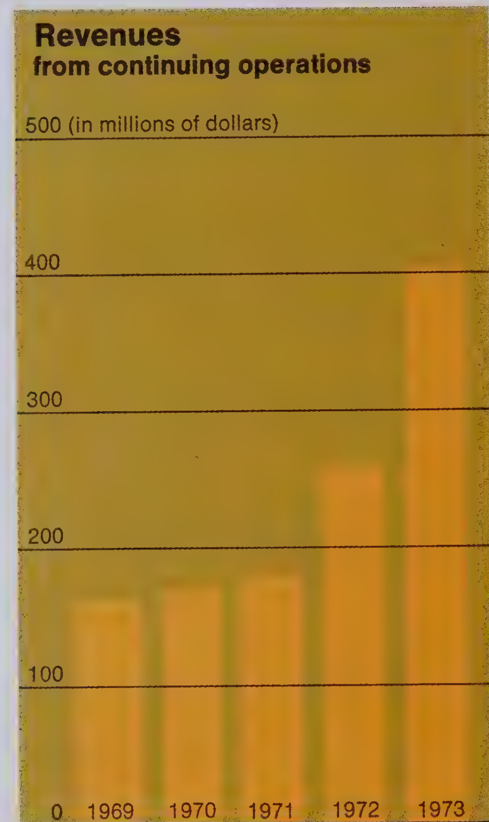
Extraordinary Credits consisted of $2,000,000 in 1973 ($817,000 in 1972) for federal income tax reduction attributable to loss carryforwards. Additional extraordinary credits in 1972 were $468,000 for gain on sale of a fertilizer plant (less income tax of $117,000) and $80,000 for gain on sale of securities (less income tax of $24,000).

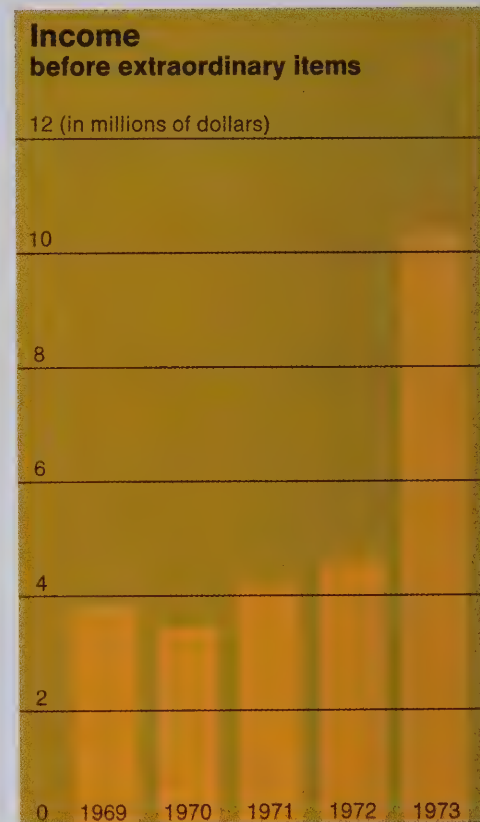
Company's Net Share, Oil and Gas Sales—1973

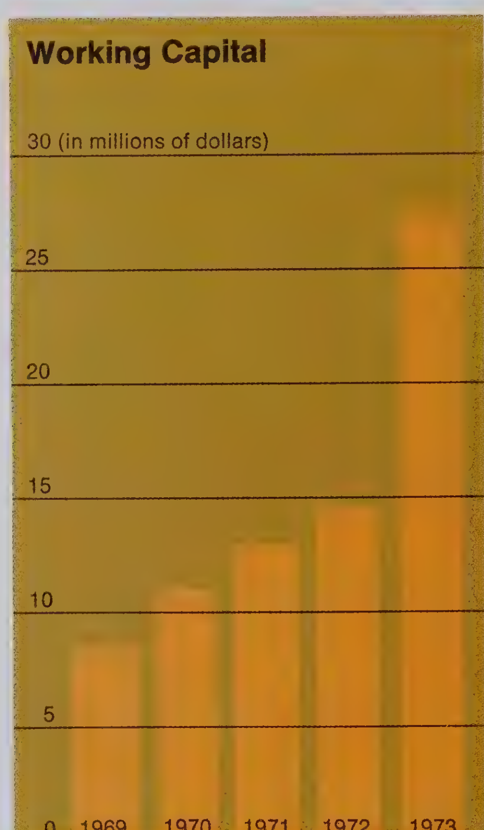
	Crude Oil and Natural Gas Liquids-Bbls.	Dry and Casinghead Gas-MCF
Texas	660,794	3,723,120
California	302,524	1,239,300
Wyoming	166,771	435,780
New Mexico	64,054	278,942
Louisiana	60,097	—
Colorado	27,082	41
Saskatchewan	1,560,098	60,576
Alberta	563,996	5,295,645
British Columbia	181,763	581,482
Manitoba	77,914	—
All Others	40,857	147,479
Totals	3,705,950	11,762,365
Average per day	10,153	32,226

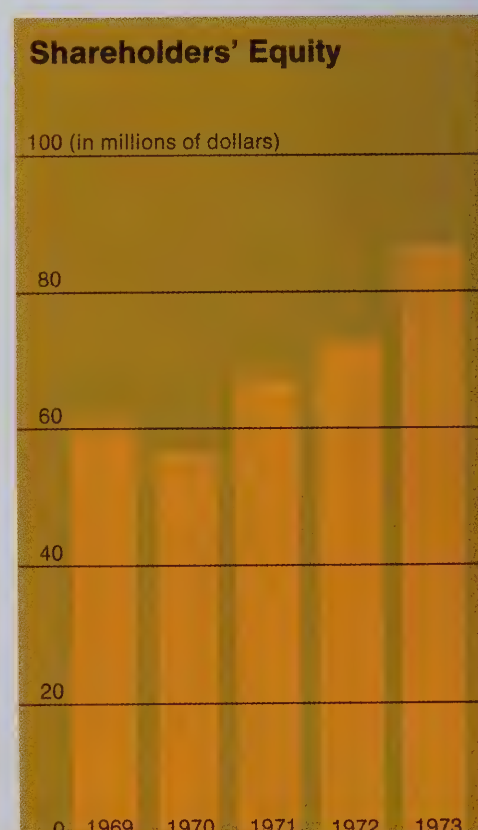
Form 10-K

The Form 10-K Annual Report to the Securities and Exchange Commission provides certain additional information and will be available in April. A copy of this report may be obtained upon request to the Secretary of the Company.


Revenues
from continuing operations
500 (in millions of dollars)
400
300
200
100
0
1969
1970
1971
1972
1973


Income
before extraordinary items
12 (in millions of dollars)
10
8
6
4
2
0
1969
1970
1971
1972
1973


Working Capital
30 (in millions of dollars)
25
20
15
10
5
0
1969
1970
1971
1972
1973


Shareholders' Equity
100 (in millions of dollars)
80
60
40
20
0
1969
1970
1971
1972
1973

Five Year Statistical Summary of Consolidated Operations

Financial: Amounts in thousands of dollars, except per-share data	1973	1972	1971	1970	1969
Revenues (from continuing operations)	$406,007	$259,200	$179,442	$173,098	$167,115
Income before extraordinary items	10,333	4,704	4,191	3,494	3,813
Extraordinary credits (charges)	2,000	1,224	200	(6,821)	1,344
Net income (loss)	12,333	5,928	4,391	(3,327)	5,157
Net income (loss) per common share	.97	.46	.36	(.35)	.46
Working capital	27,491	14,628	12,964	11,181	8,436
Reserved production payments outstanding	—	—	2,626	5,144	7,689
Shareholders' equity	86,979	73,385	67,757	57,826	61,622
Total assets	196,543	135,029	107,484	97,109	103,152
Other:					
Average common shares outstanding (in thousands)	12,271	11,927	11,159	10,883	10,478
Crude oil and natural gas liquids production, barrels per day	10,153	10,028	9,683	9,734	9,706
Natural gas sales, Mcf per day	32,226	35,955	34,122	35,363	40,053

Summary of Accounting Policies

Principles of Consolidation. Accounts of wholly- and majority-owned subsidiaries are consolidated in the accompanying financial statements.

With respect to the merger of Western Crude Oil, Inc., into Reserve in April, 1973, the following is a reconciliation of revenues, extraordinary credits and net income reported in the Consolidated Statement of Income and Retained Earnings.

	1973	1972
	(In Thousands)	
Revenues:		
Reserve (excluding Western Crude)	$ 64,527	$ 56,625
Western Crude:		
Before date of combination	71,179	202,575
After date of combination	270,301	—
	$406,007	$259,200

Principles of Consolidation (continued)

	1973	1972
	(In Thousands)	
Extraordinary credits:		
Reserve (excluding Western Crude)	$ 2,000	$ 1,168
Western Crude—before date of combination	—	56
	$ 2,000	$ 1,224
Net income:		
Reserve (excluding Western Crude)	$ 5,063	$ 5,143
Western Crude:		
Before date of combination	652	785
After date of combination	6,618	—
	$ 12,333	$ 5,928

Prior to the merger, Western Crude's fiscal year-end was September 30; accordingly, for 1972, Western Crude's financial information is included on the basis of its fiscal year. During 1973, Western Crude's fiscal year was conformed to Reserve's, and its net income of $495,000 (revenues of $60,000,000) for the three-month period October 1, 1972 through December 31, 1972 were credited to retained earnings. Retained earnings at the beginning of 1972 were increased by $2,042,000 as a result of the merger.

Foreign Operations. The accounts of Canadian Reserve and Western European subsidiaries have been translated to U.S.-dollar equivalents as follows: current assets and liabilities at the prevailing rate of exchange at the balance sheet date; non-current assets and liabilities at the rates prevailing when such assets were acquired or liabilities incurred; revenues, costs, and expenses at the average rate during the period. Translation gains or losses (not significant) are included in operating results.

Summary of Accounting Policies (continued)

The net assets and net income (after adjustments for deferred income taxes) of Reserve's Canadian and Western European subsidiaries and Reserve's equity therein are as follows:

	1973	1972
	(In Thousands)	
Net assets at year end	$35,530	$27,440
Net income	7,489	2,170
Reserve's equity:		
In net assets at year end	31,206	24,537
In net income	6,295	1,935

Land Sales—Residential. In 1972 Reserve retroactively adopted the installment method of accounting for its retail sales of residential lots and deferred direct selling expenses related to retail sales and commissions in accordance with provisions of the accounting guide "Accounting for Retail Land Sales" issued by the American Institute of Certified Public Accountants. Under the installment method, revenues include: the total selling price of property sold in the year of the sale, a charge representing deferral of gross profit, net of direct selling expenses, applicable to future collections and a credit for the gross profit on current collections. Cost of sales, indirect selling and administrative expenses are charged to expense as incurred. Reserve earns commissions under exclusive sales agency contracts on sales of subdivided land owned by others. Such commissions (net of directly related expenses) are recorded as income when collected.

Land Sales—Commercial. Reserve records sales of commercial property on the accrual basis of accounting upon receipt of a 20% down payment and execution of a contract. The contract rate of interest charged to commercial land customers is 6%. Reserve has imputed interest on commercial sales contracts at 12%.

Short-Term Investments, consisting of certificates of deposit, bankers' acceptances, commercial paper and government obligations, are carried at cost, which approximates market.

Inventories of crude oil, refined products and sulfur are carried principally at average cost, which is lower than market. Materials and supplies are carried at or below average cost. Subdivided land is carried at cost which is less than market. Property taxes and interest relating to subdivided land are expensed as incurred.

Exploratory and Leasehold Costs. Expenditures for oil and gas exploration (including geological costs, delay drilling rentals and dry hole costs) are expensed as incurred, and costs of acquiring non-producing mineral rights are capitalized and charged to expense when surrendered, except that such expenditures incurred by Canadian Reserve after December 31, 1970 are capitalized and amortized under the full-cost method of accounting.

Properties. Depletion and depreciation of the costs of oil properties and related equipment and amortization of capitalized intangible drilling costs are computed on the unit-of-production basis; buildings and other equipment are depreciated by the straight-line and declining balance methods at rates varying from 2½% to 33⅓% per annum.

Maintenance and repairs are expensed as incurred; renewals and replacements which improve or extend the life of existing properties are capitalized and depreciated. Gain or loss is recognized upon sale or retirement of assets depreciated on the straight-line or declining balance method. For properties depreciated on the unit-of-production method, the cost of the asset sold or retired, less the amount realized, is charged to accumulated depreciation.

Income Taxes. Reserve provides for deferred income taxes applicable to transactions which affect book and taxable income in different years (principally undistributed earnings of Western European subsidiaries, depreciation and sales of commercial land reported for income tax purposes on the installment method). No provision for deferred tax is made for differences of a permanent nature such as those arising from statutory depletion and intangible drilling costs. No provision is made for U.S. income taxes attributable to earnings of Canadian Reserve as it is anticipated that accumulated earnings of $13,407,000 will be permanently invested in Canada. In consolidation, Reserve eliminates deferred Canadian taxes ($957,000 in 1973; $127,000 in 1972) to conform with Reserve's method of accounting.

As a result of the Western Crude merger, net operating losses of $209,000 and investment tax credits of $253,000 are available at December 31, 1973 for carryforward which can be used only to offset future taxable income and income taxes of certain subsidiaries. The net operating losses expire in 1976 and $202,000 of investment tax credits expire in 1974, if not used prior to those dates.

Investment tax credits of $524,000 in 1973 ($61,000 in 1972) have been accounted for in the year used in accordance with the flow-through method.

In 1973, statutory depletion, allowable investment tax credits and lower tax rates on foreign income resulted in an effective tax rate of 44.3 percent of income before income taxes and extraordinary credit. The components of income tax expense are as follows:

	1973	1972
	(In Thousands)	
Federal Income Tax		
Current	$2,423	$ 822
Deferred	2,233	88
Provision offset by extraordinary item	2,000	700
State Income Tax		
Current	897	124
Foreign Income Tax		
Current	1,365	—
Deferred	(707)	188
	$8,211	$1,922

Employee Benefit Plans. Reserve adopted a company-wide retirement plan effective in 1973 for the benefit of eligible U.S. employees. 1973 pension expense was $486,000 ($152,000 in 1972 for a subsidiary), including funding of 10% of prior service cost. Unfunded prior service cost amounted to $2,865,000 at December 31, 1973. It is anticipated that funding in future years may be on a forty-year basis. The effect of such funding in 1973 would have been a reduction of $136,000 in 1973 pension expense.

Reserve also has a thrift plan for the benefit of most U.S. employees. Generally, under the plan participants are permitted to contribute from 1% to 5% of regular base pay, and Reserve contributes an amount equal to the aggregate of employee contributions. Reserve may make additional contributions under the provisions of the plan, but has never done so. Reserve's contribution of $126,000 in 1973 ($69,000 in 1972) was charged to operations.

Per-Share Data. Income per share of common stock is based on the weighted average shares outstanding, after giving retroactive effect to the shares issued in the Western Crude merger and after deduction of preferred dividend requirements. Assuming conversion of outstanding preferred stock and exercise of outstanding stock options and warrants at the beginning of the year, there would have been no dilution of the per-share amounts.

Accountants' Report

Arthur Young & Company

The Board of Directors and Shareholders
Reserve Oil and Gas Company

We have examined the accompanying consolidated balance sheet of Reserve Oil and Gas Company at December 31, 1973 and 1972 and the related consolidated statements of income and retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the consolidated financial statements of Western Crude Oil, Inc., a consolidated subsidiary, for the year ended September 30, 1972, which statements reflect total assets and net income constituting 35% and 13%, respectively, of the related consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to such amounts included for Western Crude Oil, Inc., is based solely upon the report of the other auditors.

In our opinion, based upon our examinations and the report of other auditors, the statements mentioned above present fairly the consolidated financial position of Reserve Oil and Gas Company at December 31, 1973 and December 31, 1972 and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

San Francisco, California
February 15, 1974

Principal Subsidiaries

Canadian Reserve Oil and Gas Ltd.
639-5th Avenue, S.W., Calgary, Alberta T2P OM9, Canada
Paul D. Meadows, President

Mohawk Petroleum Corporation, Inc.
550 South Flower Street, Los Angeles, California 90017
Malcolm McDuffie, President

Western Crude Oil, Inc.
1776 Lincoln Street, Denver, Colorado 80203
Cortlandt S. Dietler, President

Division and Other Offices

Executive Office:
550 South Flower Street, Los Angeles, California 90017
John R. McMillan, Chairman of the Board and Chief Executive Officer
Harold F. Green, Vice President and Secretary

General Operating Office:
1776 Lincoln Street, Denver, Colorado 80203
Paul D. Meadows, President and Chief Operating Officer

Mid-Continent Division
1806 Fidelity Union Tower, Dallas, Texas 75201
John M. Penrod, Manager

Western Division
550 South Flower Street, Los Angeles, California 90017
Robert P. Mangold, Manager of Field Operations

Apple Valley Ranchos Division
P. O. Box 1, Apple Valley, California 92307
Walter E. Cramer, Jr., Vice President

Transfer Agents

Security Pacific National Bank, Corporate Trust Division
124 West Fourth Street, Los Angeles, California 90013

The Chase Manhattan Bank, N.A.
One Chase Manhattan Plaza, New York, New York 10015

Guaranty Trust Company of Canada, 311-8th Ave., S.W.
Calgary, Alberta T2P 1C7, Canada

Registrars

The Bank of California, N.A.
550 South Flower Street, Los Angeles, California 90017

First National City Bank
111 Wall Street, New York, New York 10015

Guaranty Trust Company of Canada, 311-8th Ave., S.W.
Calgary, Alberta T2P 1C7, Canada

Stock Exchange Listings

American Stock Exchange
Pacific Stock Exchange

Shareholders and Employees

Shareholders 22,076
Employees 880